COPING WITH COVID-19 IN DIFFERING WAYS

Allianz Research

Global Economic Outlook
July 2020
GLOBAL OUTLOOK

01
<table>
<thead>
<tr>
<th>March - April 2020</th>
<th>June 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Second Covid-19 wave</strong> with targeted lockdowns by mid-2021 when a vaccine could be in place. Haphazard opening in several emerging economies (India, Indonesia, Brazil, Mexico, Turkey, South Africa) put them at high risk of policy mistake.</td>
<td><strong>Confirmed</strong>, notably in the US and the weakest emerging markets.</td>
</tr>
<tr>
<td><strong>Return to business as usual, beware of false starts:</strong> The global economy would operate at 70 to 80% capacity until Q4 2020.</td>
<td><strong>Confirmed</strong> as confidence effects will remain impaired for longer. <strong>Confirmed</strong>, supply chain disruptions.</td>
</tr>
<tr>
<td><strong>A return to pre-crisis GDP levels by mid-2021:</strong> For the manufacturing and construction sectors where social distancing is less of an issue the return was foreseen at the end of 2021 while the services sector is was not expected until mid-2021.</td>
<td><strong>Revised to Q4 2021 / Q4 2022 depending on the economy. Trade will take a few more quarters to reach its pre-crisis given the reshoring and protectionist growing trend.</strong></td>
</tr>
<tr>
<td><strong>Policy bazooka</strong> during lockdowns avoid a liquidity crisis. <strong>Insolvency wave delayed to H2 2020.</strong></td>
<td><strong>Confirmed</strong> but the changes in the insolvency laws delays even further the insolvency wave (+33% by end-2021 vs. +20% in 2020)</td>
</tr>
<tr>
<td><strong>Policy support during deconfinement (May-July):</strong> targeted relief: shifts the focus from liquidity to solvency support with targeted and increasingly conditional support.</td>
<td><strong>Confirmed</strong>. Several European States announced a prolongation of the relief support, mainly on partial unemployment schemes along direct loans to most hit sectors</td>
</tr>
<tr>
<td><strong>Policy support during recovery phase (until end-2021):</strong> from debt to cash and from deflation to reflation.</td>
<td><strong>Below expectations.</strong> Very little has been announced and no global coordination which bodes for a lower recovery in 2021. More should be announced in September but no bazooka expected.</td>
</tr>
<tr>
<td><strong>Risks to our scenario (L-shape):</strong> (i) prolonged high precautionary savings (households, companies); (ii) rise in the zombification of companies; (iii) rise in NPLs and fragile banks; (iv) rise in social inequalities and political risk; (v) policy mistakes (sanitary, fiscal, monetary); (vi) rise in protectionism and shorter supply chains which could structurally dampen companies margins.</td>
<td><strong>Maintained at 30% probability.</strong></td>
</tr>
<tr>
<td><strong>Financial markets:</strong> it can still get worse before it gets better</td>
<td><strong>On track.</strong> Still no strong signals of reentry given the divergence between equity and bond markets. Continue to expect strong volatility.</td>
</tr>
</tbody>
</table>
COVID-19: THE PHASE 2 MARATHON

Stage 1: Full lockdowns to 'flatten the curve'
- Expand healthcare capacity (treatment, testing, monitoring)
- Fiscal / monetary safety nets to reduce downside risks & cushion economic blow

Stage 2: Gradual opening of national economies
- Mass testing, tracking & isolation of new cases
- Ongoing targeted confinement measures incl. border restrictions & event bans
- Policy to focus on boosting economic recovery prospects

Stage 3: Global economy getting back on track
- Bans on large events & border restrictions to be eased as pandemics around the globe ends
- Ongoing fiscal & monetary policy support aimed at providing tailwind to rebound

Stage 4: Habemus vaccine!
- Global rollout allows for return to normalcy without border restrictions, testing & bans on large events
- Policy support can be gradually withdrawn

Fresh virus outbreak – back to stage 1

Remember we are here!

Sources: OECD, Allianz Research framework from March 2020
PHASE 2 WILL BE DARWINIAN

Retail stores visits are slowly recovering in line with the deconfinement strategies but initial conditions and lockdown stringency will push for asymmetric recoveries.

*Daily Google mobility data for „Retail“, adjusted for weekends and holidays, filtered trend
Sources: Google, Allianz Research

An unprecedented shock in the services sector with the trough being reached in April. Some countries recover faster (Germany, US) but globally the index is plateauing below pre-crisis levels.
NEW WAVELETS: LIGHT AND LOCALIZED LOCKDOWNS

De-confining: managing the effective reproduction rate
(bubble size is latest available stringency index)

Stringency indices

Daily number of new Covid-19 cases (as of 5 July 2020)

Sources: Various, Euler Hermes, Allianz Research
Sources: Oxford University, Euler Hermes, Allianz Research
Sources: John Hopkins University, Euler Hermes, Allianz Research

Many countries still battle with too high R0. Cluster management and physical distancing measures could help cap R0 for countries with previous lockdowns.

It is likely to be long before all containment measures are removed. Stringency indices have been faster to rise than decline, particularly for international travel.

Hot spots include Latin America, the United States, United Kingdom and India.
GLOBAL ECONOMY: NO RETURN TO PRE-CRISIS LEVELS BEFORE END OF 2021

Real GDP growth, %

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>World GDP growth</td>
<td>3.3</td>
<td>3.1</td>
<td>2.5</td>
<td>-4.7</td>
<td>4.8</td>
</tr>
<tr>
<td>United States</td>
<td>2.4</td>
<td>2.9</td>
<td>2.3</td>
<td>-5.3</td>
<td>3.7</td>
</tr>
<tr>
<td>Latin America</td>
<td>1.0</td>
<td>1.0</td>
<td>0.1</td>
<td>-6.8</td>
<td>3.1</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.3</td>
<td>1.3</td>
<td>1.1</td>
<td>-7.0</td>
<td>3.0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1.8</td>
<td>1.3</td>
<td>1.4</td>
<td>-13.3</td>
<td>5.0</td>
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<tr>
<td>Eurozone members</td>
<td>2.7</td>
<td>1.9</td>
<td>1.3</td>
<td>-9.0</td>
<td>6.0</td>
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<tr>
<td>Germany</td>
<td>2.8</td>
<td>1.5</td>
<td>0.6</td>
<td>-7.0</td>
<td>4.5</td>
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<tr>
<td>France</td>
<td>2.4</td>
<td>1.8</td>
<td>1.5</td>
<td>-10.8</td>
<td>7.4</td>
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<tr>
<td>Italy</td>
<td>1.7</td>
<td>0.7</td>
<td>0.3</td>
<td>-11.2</td>
<td>6.6</td>
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<tr>
<td>Spain</td>
<td>2.9</td>
<td>2.4</td>
<td>2.0</td>
<td>-11.0</td>
<td>7.0</td>
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<td>Russia</td>
<td>1.8</td>
<td>2.5</td>
<td>1.3</td>
<td>-5.2</td>
<td>3.0</td>
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<tr>
<td>Turkey</td>
<td>7.5</td>
<td>2.8</td>
<td>0.9</td>
<td>-4.7</td>
<td>4.2</td>
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<tr>
<td>Asia-Pacific</td>
<td>5.2</td>
<td>4.7</td>
<td>4.2</td>
<td>-1.3</td>
<td>5.9</td>
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<td>China</td>
<td>6.9</td>
<td>6.7</td>
<td>6.1</td>
<td>1.5</td>
<td>7.6</td>
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<td>Japan</td>
<td>2.2</td>
<td>0.3</td>
<td>0.7</td>
<td>-5.7</td>
<td>2.2</td>
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<tr>
<td>India</td>
<td>7.0</td>
<td>6.1</td>
<td>4.7</td>
<td>-3.6</td>
<td>7.5</td>
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<tr>
<td>Middle East</td>
<td>1.4</td>
<td>0.9</td>
<td>0.3</td>
<td>-6.3</td>
<td>2.2</td>
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<tr>
<td>Saudi Arabia</td>
<td>-0.7</td>
<td>2.4</td>
<td>0.3</td>
<td>-4.0</td>
<td>2.0</td>
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<tr>
<td>Africa</td>
<td>3.1</td>
<td>2.7</td>
<td>1.9</td>
<td>-3.1</td>
<td>4.0</td>
</tr>
<tr>
<td>South Africa</td>
<td>1.4</td>
<td>0.8</td>
<td>0.3</td>
<td>-7.8</td>
<td>5.4</td>
</tr>
</tbody>
</table>

* Weights in global GDP at market price, 2019
NB: fiscal year for India
Sources: National sources, Euler Hermes, Allianz Research

Global GDP growth, index

Radical uncertainty on epidemiological development, US election, policy cliff-edge effect

Which economies will drive the global recovery? United States, Germany and China (although a far cry compared to GFC). Who are the laggards? United Kingdom, France, Spain, Italy, vulnerable EM (e.g. Latin America, Turkey, South Africa, India)
As a result of Covid-19 we have downgraded a record number of sectors (325) in Q2 2020. The current crisis has led to a downgrade of 4 in 10 of our sector risk ratings since Q4 2019. In most cases, they were triggered by two factors: the demand shock and its direct and indirect impact on either the profitability or the liquidity outlook. The most downgraded sectors are those in the frontlines facing Covid-19 consequences, namely transportation, automotive and retail.
**MONETARY BAZOOKA: UNPRECEDENTED BALANCE SHEET EXPANSION, DIFFERENTIATED RETURNS**

As monetary policy continues to backstop sovereign and corporate bond markets to ensure favorable refinancing conditions, the balance sheets of all major central banks will continue to balloon in 2020/21, heading towards 50% of GDP.

Monetary policy response to the Covid-19 crisis was strong across the world. Among major economies, we estimate that the monetary impulse is the largest in the U.S.
LOOKING FORWARD, EUROPE WILL HAVE TO CARE FOR ITS BANKS

10yr yields on UST & Bund vs. Fed funds rate and ECB deposit rate (%)

Fed committed to ultra forward guidance, rates near 0 through 2022: plausible. ECB provided weak forward guidance (policy pause): be aware of zombie banks

The Fed has only bought ~$15bn of traded corporate debt and provided $30bn of commercial paper (~$750Bn total during the GFC crisis). Due to the Feds’ forward guidance, corporate spreads seem to be underestimating corporates credit risk.

The most vulnerable sectors already feature elevated levels of non-performing loans and represent a high exposure for banks.

Sources: Refinitiv, Allianz Research.

US Federal Reserve – Corporate Securities Operations

Distribution of banks across NPL ratio in the EU

Sources: Refinitiv, Allianz Research.

Sources: EBA, Allianz Research
Emergency fiscal spending ranges from 3% of GDP to 18%; the recovery stimulus effort will be a key differencing factor in the countries’ future trajectories. At the global level USD10.4tn of fiscal stimulus has been announced.

The size of automatic stabilizers will matter for the size of the fiscal stimulus packages.
In the 5 largest European countries, 9 million workers (20% of those currently partially unemployed) still face an elevated risk of becoming unemployed in 2021 because of the muted recovery. These “zombie jobs” require ad hoc policies to avoid postponed mass unemployment.

This will continue to feed into precautionary savings. We estimate savings rate to remain +6pp above pre-crisis levels at the end of 2020 which represents EUR370bn of excess savings in the EU, or 2.5% of GDP.
SOCIAL RISK ON THE RISE, FISCAL DILEMMA AHEAD?

Social risk hotspots

Sources: Euler Hermes, Allianz Research

Taxes – companies vs households (OECD average)

Sources: OECD, Euler Hermes, Allianz Research
THE OTHER REAL SECOND WAVE: A SURGE IN GLOBAL INSOLVENCIES

Insolvency figures and forecasts (selected countries)

<table>
<thead>
<tr>
<th>2007-2009 crisis</th>
<th>2020</th>
<th>Forecasts</th>
</tr>
</thead>
<tbody>
<tr>
<td># of years with an increase</td>
<td>CAGR</td>
<td>Changes over 2007-2009</td>
</tr>
<tr>
<td>U.S.</td>
<td>3</td>
<td>45%</td>
</tr>
<tr>
<td>Canada</td>
<td>0</td>
<td>-</td>
</tr>
<tr>
<td>Brazil</td>
<td>1</td>
<td>25%</td>
</tr>
<tr>
<td>Germany</td>
<td>2</td>
<td>6%</td>
</tr>
<tr>
<td>France</td>
<td>3</td>
<td>11%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2</td>
<td>22%</td>
</tr>
<tr>
<td>Italy</td>
<td>2</td>
<td>23%</td>
</tr>
<tr>
<td>Spain</td>
<td>3</td>
<td>76%</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>2</td>
<td>32%</td>
</tr>
<tr>
<td>Russia</td>
<td>0</td>
<td>-</td>
</tr>
<tr>
<td>Turkey</td>
<td>2</td>
<td>2%</td>
</tr>
<tr>
<td>South Africa</td>
<td>3</td>
<td>11%</td>
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<tr>
<td>China</td>
<td>2</td>
<td>12%</td>
</tr>
<tr>
<td>Japan</td>
<td>2</td>
<td>9%</td>
</tr>
<tr>
<td>Australia</td>
<td>2</td>
<td>16%</td>
</tr>
<tr>
<td>South Korea</td>
<td>1</td>
<td>19%</td>
</tr>
<tr>
<td>GLOBAL INDEX</td>
<td>3</td>
<td>16%</td>
</tr>
</tbody>
</table>

Sources: Euler Hermes, Allianz Research

Lockdowns of business courts, temporary policy measures to support companies and temporary changes in insolvency regimes are pushing down official registrations of bankruptcies for the short term – lowering the expectations for the full year 2020.

The ending of temporary factors will lead to a massive trend reversal starting in Q3 or Q4 depending on countries. Our global insolvency index would surge by +35% by end of 2021 i.e. +by 16% in annual average. Should policy relief be withdraw too fast the rises will be +5 to +10pp higher.
Companies are in a position to increase their investments during the recovery phase. Increases in net savings in 2020 are the highest in Italy, the UK and France. But this will be dependent on renewed confidence in a lasting restart of growth in Europe.

Public support to reduce companies’ fixed costs (lower social contributions, lower corporate taxes and/or fiscal incentives to invest) will be key. Expanding the state guaranteed loan schemes into 2021 could also be supportive for future company investment.
We find that more than 13,000 SMEs & MidCaps (7% of total) in the six biggest Eurozone countries were classified zombies before Covid-19 crisis. Low equity ratios for some companies has pushed them into high indebtedness since 2009, which will continue to increase thanks to State Guaranteed Loans.

This coupled with already fragile company margins increases the zombification of the corporate sector.
Trade could plummet by -15% in volume terms (-20% in value) due to the Covid-19 shock on goods and – for the first time – on services.


The oil and commodity price shock will lead to a negative price effect on trade in 2020. 2021 will see a return to 52.5 after an average of 47 in 2020.
Around each recession, supply chains become a concern. This time around, the concern has peaked among companies and policy makers. Building resilience and reshoring are the new rhetoric.

**Arguments in favor of reshoring**

- **Resilience**: Reshoring creates resilience due to lower risks, and shorter lead times
- **Strategic sectors**: Reshoring specific supply chains for key strategic sectors such as the medical sector, similarly to the military sector, could make sense
- **Flexibility**: More local supply can also enhance agility, as companies can be more responsive to changes in local demand.
- **Innovation**: Reshoring for cost-competitiveness reasons is unlikely, but race for product innovation is better

**Arguments against reshoring**

- **Social discontent**: Growing social discontent could be incompatible with reshoring, as it would entail high labor costs passed down to the consumer
- **Risk assessment complexity**: Reshoring does not necessarily mean de-risking: it can also mean putting all your eggs in the same basket, leading to excess concentration
- **Cost effectiveness and incentives**: Reshoring is hardly reversible for many sectors, or at a high cost for companies. Moreover, Incentives for businesses to reshore are still lacking
- **Creative destruction**: Reshoring is not only job creation... it’s job destruction through innovation, for instance robotization.

Sources: Bloomberg, Euler Hermes, Allianz Research
## RISKS TO OUR OUTLOOK

### H2 2020

**Upside risks**  
- Better-than-expected trade flows, tourism receipts and recovery in the services sector (exports-exposed economies benefit, e.g. Germany)  
- Stronger policy support and stimulus (e.g. European bad bank, UK, China, etc.)  
- Declining financial risks in domestic financial system, markets, external financing, etc. (e.g. Italy, Turkey, China, India, etc.)  
- Appeased socio-political risks, restoring domestic and external confidence (e.g. Brazil, Hong Kong, etc.)

**Downside risks**  
- Strong lockdowns to fight a second Covid-19 wave  
- Protectionism and slow global trade recovery (e.g. Germany, UK, trade hubs, etc.)  
- Sustained risk aversion limiting capital flows to EMs and pressuring economies with large external financing needs  
- Policy mistake (e.g. EU, France, Italy, China, India, etc.)  
- Domestic imbalances correction (e.g. German real estate, Indian financial sector)  
- Social risks and protests worsen

### 2021

**Upside risks**  
- Vaccine available earlier than expected, tourism returns to pre-crisis levels  
- Stronger policy stimulus, notably improving investment and the labour market (e.g. China, France, United Kingdom, Italy, etc.)  
- Oil and commodities prices rebound (benefitting e.g. Russia, Kazakhstan, Azerbaijan, the GCC, Latin America, etc.)

**Downside risks**  
- Protectionism intensifies and global trade does not recover  
- Strong lockdowns to fight waves of Covid-19 outbreaks  
- Political risk, policy mistakes (e.g. Italy, EU, UK, India, HK)  
- Sustainably higher unemployment rate, threatening the consumer-led recovery (Germany, China)  
- Deteriorating bank asset quality, sometimes leading to bailouts and feedback loop (e.g. Italy, France, China, India)  
- Debt distress and currency crises (some emerging countries, e.g. in Central Europe, Africa, Latin America)

### Beyond 2021

**Upside risks**  
- Stronger policy stimulus and policy coordination, resolving structural issues and supporting potential growth (e.g. EU, Italy, China)  
- Exports competitiveness improving, notably on supply chains reshoring (Central Europe, UK, etc.)

**Downside risks**  
- Protectionism intensifies and calls into question growth models (Germany, trade hubs, China, etc.)  
- Debt sustainability and banking sector concerns worsen (France, Italy, China, India, some countries in Africa, etc.)  
- Lack of structural reforms or missed opportunities cap productivity (China, India, UK, Central Europe, etc.)  
- Fiscal consolidation (U.S., China, etc.)  
- Socio-political risks heighten
PROTRACTED CRISIS SCENARIO (30%)

U-SHAPED RECOVERY
- Drastic confinement measures, taking heavy toll on economy & markets
- Sharp recession in H1 20 across DMs & several large EMs, followed by weak recovery
- Belated & uncoordinated policies
- Persistent localized containment measures; incl. targeted travel restrictions
- Aggressive fiscal & monetary easing
- Direct support measures

ECONOMIC IMPACT

<table>
<thead>
<tr>
<th>GDP growth, %</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>-4.7</td>
<td>+4.8</td>
</tr>
<tr>
<td>US</td>
<td>-5.3</td>
<td>+3.7</td>
</tr>
<tr>
<td>China</td>
<td>+1.5</td>
<td>+7.6</td>
</tr>
<tr>
<td>Eurozone</td>
<td>-9.0</td>
<td>+6.0</td>
</tr>
<tr>
<td>UK¹</td>
<td>-13.3</td>
<td>+5.0</td>
</tr>
</tbody>
</table>

Global trade volume 2020 -15%
Insolvencies 2020-21 +33%

PROTRACTED CRISIS
- Longer health crisis triggers brutal market dive
- Systemic credit event leads to liquidity crisis
- Policymakers unable to restart growth
- Reinfections with generalized domestic confinement
- Borders closed again until end-2020
- Even more aggressive fiscal & monetary policy
- Not very effective

ECONOMIC POLICY

<table>
<thead>
<tr>
<th>GDP growth, %</th>
<th>2020</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>-9.4</td>
<td>-0.5</td>
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<td>US</td>
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<td>China</td>
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<td>+1.8</td>
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<td>Eurozone</td>
<td>-20.0</td>
<td>-2.5</td>
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<tr>
<td>UK¹</td>
<td>-24.0</td>
<td>-5.0</td>
</tr>
</tbody>
</table>

Global trade volume 2020 -30%
Insolvencies 2020-21 +90%
The consensus is expecting a V-shape recovery of EPS in 2020, followed by a ‘normal’ rise in 2021. It proves the detachment between the markets and economic data. The same trend remains across the globe.
The path of the dividend futures follows different directions in the US and Europe. The divergence between the S&P 500 and its’ dividend futures hints that the market galloped too fast.
The overvaluation of the US equity market relative to the German equity market has reached unseen highs. A recent rally in European equity markets has slightly diminished this overvaluation. However, the US market overvaluation remains acute.

Source: DataStream, Allianz Research
Several structural leading indicators show that the downturn market trough has not yet been reached. Looking at our proprietary EQ sector dispersion index as an example, the current value and trend of the indicator does not show any strong signs of improvement and thus it does not warrant shifting towards a re-risking strategy.

As another example, institutional inflows into MM Funds have historically started declining before markets bottomed. This precondition has not yet been fulfilled. Consequently, this indicator (as it is still increasing or flat) suggests that markets have not yet reached their bottom. At this point in time, daily and weekly indicators (sentiment driven) are showing that the market trough is already behind us. However, structural indicators (Monthly and Quarterly) have not yet shown any signs of improvement.
GOVERNMENT BONDS: NO INFLATION IN SIGHT?

In the context of lower for longer central bank rates, yields are expected to remain on fundamental negative sloping trend. Our proprietary model suggests that 10y USTs will reach 1.4% by the end of 2021, inline with our current forecast. For 2020, we still expect 10y USTs to finish the year at 1.0%.

At current valuation levels we believe inflation expectations to play the key role moving forward, as real yields are expected to remain subdued. Both US and EUR inflation expectations are currently close to the lower range of our models. **At current levels, it is possible to buy inflation protection at a low price.**

If the bond market is still a market, it is currently pricing a global recession and a prolonged absence of global inflation. In the case of the bund, we still expect 10y bunds to finish the current year at -0.5% and to perform a timid climb by the end of 2021 (-0.3%).
With equity markets ready for a V-shaped scenario, we still expect 2020 performance to be on the bearish side. We believe global equity markets will end 2020 with an ~20% yearly performance. With our forecasts in mind, we understand that a second market correction could be in the pipeline (specially in the US). Moving forward, we expect the most vulnerable countries to remain the laggards of the current economic downturn. (e.g. Brazil)

Even if not all central banks have announced their willingness to take credit risk in their balance sheets, global corporate IG & HY markets have enjoyed a period of declining financing costs since the peak in mid-march. At this point, we expect corporate spreads to finish the year close to current levels but we acknowledge that corporate spreads are vulnerable to second wave of strong widening should the economic and pandemic data further deteriorate.
While it is true that emerging market sovereign debt has been gaining weight within the global sovereign market universe over the past years, its consideration (from an international investor perspective) remains that of a mid to high risk asset. Because of that, it is subject to be sold in high uncertainty environments. As of today, we still expect a second wave of EM debt and equity sell-off.

The capital outflows experienced in March led to a rapid depreciation of emerging markets currencies paired with a quick increase in long-term sovereign yields. Due to this embedded volatility, we believe that both exchange and long-term interest rates will keep wandering erratically throughout 2020 remaining an unwanted casualty of the currently unsettled short-term market sentiment.
USA: HOUSEHOLDS TO FACE A REVENUE CLIFF

The termination of helps dedicated to absorbing the shock at a labor market level, will represent a so-called revenue – cliff.

Sources of revenues for households (USD bn)

- Proprietors’ income with IVA and CCAdj
- Compensation of employees
- Unemployment Insurance Benefits
- Other government social benefits inc. One time checks
- Others
- Personal income

Sources: Nomura, Allianz Research

US unemployment and saving rates (%)

Forecast

High uncertainty and conviction that public debt will need to be reimbursed in the future will weigh long-lastingly on households’ savings rate.
The Fed has absorbed the bulk of debt newly issued by the US government, even if it not directly intervenes on the primary market.

We expect the US public deficit to be close to 16% of GDP in 2020 and close to 10% of GDP in 2021. Over the long-term, the US public debt is expected to steadily increase whatever the outcome of the election.
US ELECTIONS: WHAT IS AT STAKE?

Taking into account the regime of performance of 10 different macroeconomic indicators, our model suggests that President Trump has a 22% probability only to win the next election.

Model studying the potential of growth shows the negative impact of (much higher) public debt. To this regard, differences between Trump and Biden are not significant (higher fiscal support to productivity for Trump versus active population for Biden)
## TRUMP VS BIDEN ECONOMIC PLAN

<table>
<thead>
<tr>
<th>Infrastructure</th>
<th>Taxes</th>
<th>Health care</th>
<th>Jobs &amp; wages</th>
<th>Student debt</th>
<th>Climate change</th>
<th>Trade</th>
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<tbody>
<tr>
<td><strong>Donald Trump</strong></td>
<td>• USD2tn &quot;very big and bold plan&quot;</td>
<td>• Extend 2017 tax overhaul for individuals (USD1.5tn)</td>
<td>• Deep health care spending cuts to Medicaid (USD900bn) and Medicare (USD450bn)</td>
<td>• Spur job creation through the USD2tn infrastructure plan</td>
<td>• 7.8% budget decrease for Dpt of Education in 2021</td>
<td>• No sizable government policy on climate change</td>
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<td></td>
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<td>• Repeal renewable energy tax credits</td>
<td>• 10% cut from the 2020 enacted level for the Department of Health and Human Services</td>
<td></td>
<td>• Eliminate Public Service Loan Forgiveness and subsidized loans</td>
<td>• Pursue “America First” policy. Continuity of current trade policy</td>
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<td></td>
<td></td>
<td>• Tax credits for U.S. education</td>
<td>• Cut in drug prices</td>
<td></td>
<td>• Forgive undergrad loans after 15 y instead of 20 y and raise period for graduate loans repayment to 30 from 25 y.</td>
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<td></td>
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<td>• Raise the Internal Revenue Service (IRS) budget by about USD15bn</td>
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<tr>
<td><strong>Joe Biden</strong></td>
<td>• 10-year USD1.3tn infrastructure plan</td>
<td>• Raise top income tax rate back at 39.6% from 37% and top corporate income rate to 28% from 21%</td>
<td>• Eliminate the 400% income cap on tax credit eligibility and lower the limit on the cost of coverage to 8.5% of income</td>
<td>• Cancel a minimum of USD10,000 of student debt per person</td>
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<td>• Plan focuses on climate change ($400bn for clean energy, research and innovation)</td>
<td>• Apply Social Security taxes to earnings &gt; USD400,000</td>
<td>• Create a public health insurance</td>
<td>• Forgive all undergraduate, tuition-related federal student debt for low-income and middle class individuals (earning up to USD125,000)</td>
<td>• Achieve 100% clean energy economy and reach net-zero emissions no later than 2050.</td>
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<td>• Tax capital gains and dividends at ordinary rates for those with annual incomes &gt; USD 1m</td>
<td>• Lower eligibility age for Medicare to 60 from 65.</td>
<td>• Increase the federal minimum wage to $15</td>
<td>• Join Paris Agreement + ban fossil fuel subsidies</td>
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<td>• 15% minimum tax on book income of large firms</td>
<td>• This plan will insure more than an 97% of Americans and cost USD750bn</td>
<td>• Increase employment-based green cards from 140,000 each year</td>
<td>• Install 500,000 EV charging stations nationwide by 2030</td>
<td>• Investing in innovation and the middle classes</td>
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<td>• Double tax rate (to 21%) on profits earned by foreign subsidiaries of U.S. firms</td>
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<td></td>
<td>• Ban new permits for oil and gas drilling on federal land and offshore</td>
<td>• Best way to confront China on IP + tech transfers is by forming a coalition w/ allies and partners, not through tariffs.</td>
</tr>
</tbody>
</table>
Industrial activity is now probably c.5% below usual levels. On the consumption and services side, it could take longer for confidence and households behaviours to return to normal: property transactions remain -34% below usual volumes, dining bills (including take-outs) are c.-40% below pre-outbreak and household disposable income declined by -3.9% y/y in real terms in Q1 2020 (vs. +5.8% in 2019).
After the slump in GDP growth in Q1 (at -6.8% y/y), we expect a gradual recovery, becoming more visible in H2. We expect 2020 GDP growth at +1.5%.

Leading indicators point to the unemployment rate remaining at elevated levels (around 1pp above long-term average) for the rest of 2020.

We expect fiscal support amounting to 7.1% of GDP (up from 2.7% forecast before the COVID-19 crisis). In terms of monetary policy, further injections of liquidity and policy rate cuts are likely.
**HONG KONG SCENARIOS AS OF JULY 2020**

### Improving environment (10%)

**Triggers:**
- No further sanctions and retaliations between China and the U.S.
- Mainland China sends clear signals that business regulatory environment in Hong Kong will not change, and significantly increases investment in Hong Kong to help recovery

**Economic impact:**
- In the short-term: stronger recovery of Hong Kong economy, with GDP growth forecasts in 2020 and 2021 increasing to -4.2% and +7.9% respectively.
- In the medium-term: back to pre-Covid-19 and pre-2019 protests normal.

### The ‘New Normal’ (65%)

**Scenario:**
- China’s national security law theoretically threatens the independence of Hong Kong’s legal system, but its implementation does not disrupt the business environment
- U.S. actions include financial sanctions on Chinese officials involved in the national security law, tightening of visa requirements, exports restrictions to Hong Kong

**Economic impact:**
- In the short-term: continued small-scale protests in Hong Kong. Impact of trade sanctions is limited (less than 1% of Hong Kong GDP if same tariff hikes as those applied to mainland China over 2018-19). Hong Kong’s 2020 and 2021 GDP growth forecasts revised down to -5.9% and +4.1% from -4.7% and +4.5% respectively.
- In the medium-term: U.S. FDI to Hong Kong slows, but without divestment. FDI from mainland China accelerates.

### Deteriorating environment (25%)

**Triggers:**
- Disruption of business environment due to China’s national security law in Hong Kong, strong retaliation against U.S. actions (e.g. on U.S. FDI into Hong Kong), along with long term trend of developing regional trade and financial hubs in the mainland.
- The U.S. treats Hong Kong as mainland China for trade and direct investment, and is followed by other developed countries

**Economic impact:**
- In the short-term: damaged business and consumer sentiment jeopardize the recovery. GDP growth forecasts in 2020 and 2021 falling to -6.6% and +0.8% respectively.
- In the medium- to long-term: Divestment of U.S. firms, stock of FDI could decline by almost half in coming five years (nearly USD20bn). Not necessarily compensated by FDI from mainland China, as focus is on domestic hubs.

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The Eurozone economy has passed the trough, but high-frequency indicators are suggesting that the recovery will be gradual, drawn-out and uneven across countries. On average pre-crisis GDP will not be reached before 2023.

Looking at selected key drivers of divergence (policy decisions on lockdown length & strictness, fiscal response economic features such as the size of the service sector) explains which the UK, Spain and Italy will lag the other Eurozone countries and in particular Germany.
National fiscal policy continues to lead the policy response in the Eurozone. The Eurozone budget deficit will rise to 10% in 2020 and still come in at 4% in 2021, with none of the large Eurozone countries complying with the Maastricht 3% limit over the forecast horizon.

In addition, the economies most affected by the Covid-19 crisis – as well as those with lower GDP per capita – look set to receive some much needed fiscal tailwind for investment from the EU recovery fund. We estimate that GDP levels on average could be boosted by 0.4% per year over the next 5 years.
Firms’ appetite for loans has risen dramatically in H1 2020 – thanks to governments extending generous state guarantees. Meanwhile, the demand for housing and consumer loans is hinting at an anemic recovery.

Loan take up is for now driven mostly by imminent liquidity needs in the face of sharply lower business revenues. Investment for now is not a priority – especially in the more affected Southern Eurozone countries.

Sources: ECB, Refinitiv, Allianz Research
Germany is an early-opener however a subdued growth outlook for its key trading partners – EU & non-EU – will keep a lid on the recovery, particularly in manufacturing. The consumer however appears more resilient, and construction is a key trump. After a -7% contraction in 2020, GDP will grow 4.5% in 2021.

German fiscal policy is playing in a league of its own in size, timing and composition. The latest stimulus package aimed at providing tailwind to the recovery should add around 1ppt to GDP growth in 2020 and another 0.5ppt in 2021.
Consumer spending is recovering in May, relatively stronger than in other European countries. However, there are doubts that this would be sustainable given rising in unemployment fears.
Major consumption shock in H1, investment still suffering from uncertainty and funding constraints due to banking vulnerability. Trade balance worsening due to strong decline in tourism receipts and world trade. Relative moderate rebound in 2021 due with GDP remaining 3% below pre-crisis level.

Public debt will increase strongly in 2020 due to fiscal measures and GDP drop (165% GDP). Debt sustainability is not at risk in the short term as ECB contains risk of rising yield/spreads. Debt/GDP will remain above 140% for long period of time (~10y).
THE UK: SMALL IS THE “NEW DEAL”, BREXIT-CONSTRAINED*?

New loans to corporates, GBPbn

Sources: ONS, Allianz Research

Real wage growth, y/y

Sources: ONS, Allianz Research

Real GDP during the recession, 100 = pre-recession peak

Sources: ONS, Allianz Research

*After 4 long years of Brexit negotiations, we expect a 5th one. Soft Brexit (70%) by Jan 2022
EMERGING MARKETS: CAPITAL FLOWS BOTTOMING OUT BUT RISKS OF SUDDEN STOPS STILL REMAIN

Emerging Markets: Net portfolio flows by region (USD bn)

Emerging Markets: Gross external financing requirement (% of FX reserves)

Net portfolio flows to EM dropped sharply to a record low of -USD 89 bn in March. But moderate rebound already in April (+USD23bn), May (+USD2bn) and June (first estimate +USD33bn).

In Turkey and Argentina, gross external financing requirements rose further from around 250% at end-2019.
Turkey has by far burned the most FX reserves this year to defend its currency – albeit with limited success. Net FX reserves dangerously low now. Watch out for Brazil, South Africa and Mexico.

Some EMs have begun to purchase government bonds to ensure smooth functioning of bond markets and sufficient liquidity for banks to support private sector credit. This is mostly different from QE in AEs and much smaller in scale. Indonesia, Turkey, Brazil, Poland and Croatia require monitoring.
Easing currency pressures allowed rate cuts. CBs in PL, TR, HU and RO began to purchase government bonds to ensure smooth functioning of bond markets and sufficient liquidity for banks to support private sector credit. This is different from QE in AEs and much smaller in scale.

Direct fiscal stimulus is still modest. Public finances will deteriorate but remain manageable overall.

All economies in the region will be in recession. The depth of recession is influenced by the size and efficiency of policy measures (lockdowns and stimulus) and, importantly, the dependence on export of goods and services.
Huge net portfolio investment outflows in Jan-Apr 2020. Plus significant net bank debt outflows (which were already negative in the previous four full years).

Net FX reserves dwindled to less than USD20bn in May 2020 as the CB burned reserves to defend the lira – with limited success. Expect currency turbulences in H2 2020.
**LATAM: DEEP RECESSION, STIMULUS AT WORK, BUT LARGE JOB LOSSES AHEAD**

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<td>Argentina</td>
<td>-2.1</td>
<td>2.7</td>
<td>-2.5</td>
<td>-2.2</td>
<td>-8.1</td>
<td>5.5</td>
</tr>
<tr>
<td>Brazil</td>
<td>-3.3</td>
<td>1.3</td>
<td>1.3</td>
<td>1.1</td>
<td>-7.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Chile</td>
<td>1.7</td>
<td>1.2</td>
<td>3.9</td>
<td>1.0</td>
<td>-5.2</td>
<td>2.2</td>
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<tr>
<td>Colombia</td>
<td>2.1</td>
<td>1.4</td>
<td>2.5</td>
<td>3.3</td>
<td>-5.3</td>
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<tr>
<td>Mexico</td>
<td>2.9</td>
<td>2.1</td>
<td>2.1</td>
<td>-0.3</td>
<td>-7.5</td>
<td>2.6</td>
</tr>
<tr>
<td>Peru</td>
<td>4.1</td>
<td>2.5</td>
<td>4.0</td>
<td>2.2</td>
<td>-9.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Latin America</td>
<td>-0.1</td>
<td>1.8</td>
<td>1.5</td>
<td>0.7</td>
<td>-6.5</td>
<td>3.1</td>
</tr>
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</table>

Sources: IMF, Euler Hermes, Macrobond, Euler Hermes, Allianz Research

No country will escape recession, due to the stringent lockdowns (esp. Argentina, Peru and Chile), exposure to commodities & global trade integration.

As money supply (M2, a measure of liquidity) has shot up, so has credit to the private sector, indicating the pass-through of the stimulus to companies.

The policy focus was on debt finance rather than unemployment support. We expect significant informal and formal job losses in Latin America as a result.
As of June, despite easing of lockdowns, confidence has barely recovered; this bodes ill for industrial production; overall, activity is still 26% below pre-crisis levels, which signals a sluggish recovery.

The Economic Policy Uncertainty index is at its highest since early 2017. At the exit of the crisis, further tensions between the central administration and Congress + local governors could halt reforms.
We have revised down GDP growth for the Asia-Pacific region from +4.2% prior to the global pandemic to -1.3% in 2020 (after 4.3% in 2019).

Global trade should overall remain under pressure this year, but exposure to China could be comparatively supportive.

Different initial conditions and economic structures require varying levels of policy supports. India, Indonesia, Vietnam and Thailand could do more to protect employment.
India has started to de-confine, even though data suggest the epidemic is not yet controlled. This means that activity resumption could be even slower than in other economies.

Risks are skewed on the downside. Policy leeway is limited by twin deficits, and a vulnerable financial system. In the medium run, we are more concerned about India’s financing requirements.
Huge export losses to be expected across the region in 2020, in particular in oil exporting countries. Only moderate recovery in 2021 as oil output is unlikely to be ramped up.

All economies in the region will be in recession in 2020, at diverging degrees. The slowdown/recession will be much stronger than in 2009.
GCC: FISCAL AND EXTERNAL POSITIONS WILL MARKEDLY WORSEN AGAIN, AS IN 2015-2016

Fiscal and current account breakeven oil prices 2020f (USD/bbl)

The currency pegs limit both monetary and fiscal policy leeway. The oil price slump translates directly into lower fiscal revenues in local currencies since the exchange rate does not work as an automatic stabilizer. Hence, all GCC economies except the UAE will run twin deficits in 2020.

Saudi Arabia, the UAE, Qatar and Kuwait have large SWFs, which can act as buffers against the revenue shocks and softening the risk of non-payment. But Bahrain and Oman have relatively small SWFs. Bahrain ran already out of policy buffers in 2017 and has since “survived” thanks to financial support from Saudi Arabia and UAE. Oman is likely to follow in the next years. => Downgrade to C3.
AFRICA: -3.1% RECESSION, FIRST IN 25 YEARS

In 2020 we expect the continent to enter into recession -3.1%, for the first time in 25 years. In 2021, we expect the GDP to rebound by +4%.

Angola, Mozambique and Egypt were already strongly indebted in 2019. On the other hand, Zambia, Egypt, Kenya, Ghana and Mauritius already had high budget deficits before the COVID-19 outbreak.

Source: Euler Hermes, Allianz Research, National statistics
THANK YOU

Allianz Research

Global Economic Outlook
July 2020