

# September Economic Update: V for virus, vaccine, and a V-shaped recovery?

Three new scenarios for the global economy as the recovery heads for a turbulent winter

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By Carsten Brzeski, Chris Turner and 6 others

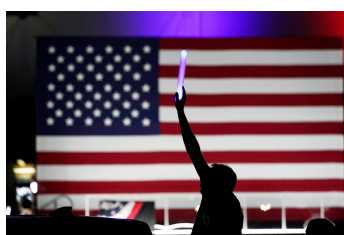


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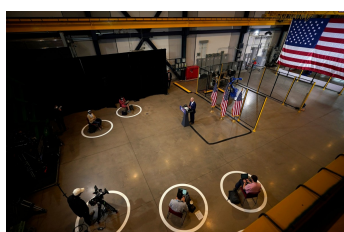


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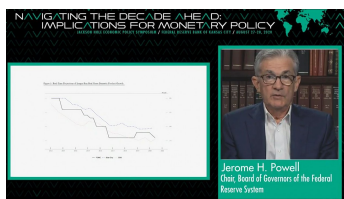


FX

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### Rates: Why we want a steeper curve

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By Padhraic Garvey, CFA

Report | 3 September 2020

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Three new scenarios for the global economy as the recovery heads for a turbulent winter



Source: Shutterstock

- **Three new scenarios for the global recovery's next phase**

With the economic rebound from Covid-19 now in full swing, we look at what could be a turbulent path to full recovery. Our new-look scenarios map out potential paths for the global economy depending on how the virus spreads over the winter, and how quickly a vaccine is certified and rolled out to the wider population

- **US: The surge subsides**

High-frequency data suggests that the post-reopening surge in activity began to moderate in July and this process continued throughout August. With the pandemic continuing to create many challenges, we doubt the economy will fully heal before 2022

- **US Politics: Biden's to lose?**

Opinion polls suggest Joe Biden has a commanding lead over President Donald Trump, but with two months to go, there are plenty of things that could change that situation. Whoever wins, the battle for the House and Senate will be critical to determining how many of their respective

promises can be delivered

- **Eurozone: The rebound continues... for now**

The eurozone is still on track to see a very strong third-quarter growth figure. However, recent indicators signal some deceleration. Meanwhile, inflation is undershooting expectations paving the way for an extension to the Pandemic Emergency Purchase Programme

- **Eurozone: Short-time work provides cushion to double dip worries**

Worries about a double-dip recession are increasing in the eurozone as disappointing survey data for August provides a reality check on the pace of recovery. Government support offers a significant tailwind for the economy though. While a double-dip is not unthinkable, it looks like growth can still continue albeit at a slower pace in the coming months.

- **UK: What Brexit means for the economy in 2021**

We think it's unrealistic to expect a sudden plunge in GDP once the transition period ends. But whether there's a deal or not, the change in UK-EU trade terms will push costs up for businesses in a range of sectors, potentially compounding the Covid-19 hit. That leaves the UK at risk of a slower and more turbulent recovery relative to its peers

- **Central and Eastern Europe: No deflationary threat here**

Growth in the CEE region is picking up in line with the eurozone, but in contrast, inflation remains above target. Central banks are unlikely to respond as they focus on the fragile post Covid-19 recovery, while local CPIs are set to fall. CEE FX has been benefiting from rising EUR/USD and should continue to do so.

- **China: Revising GDP and yuan forecasts**

China's recovery has started and looks sustainable because domestic demand has returned amid fewer Covid-19 cases. This leads us to revise our GDP forecast up to 2.5% YoY and yuan forecasts upward to 6.70, but the technology war is still the biggest risk to the economy

- **Asia (ex. China): Slow recovery**

Shinzo Abe's resignation as Japan's Prime Minister has grabbed the headlines this month. Elsewhere, recovery continues across the region, with North Asia outpacing the rest

- **FX: The dollar bear trend: It's only just begun**

US fiscal policy paralysis and a change in monetary policy strategy from the Federal Reserve make the case for the dollar bear trend extending well into next year. We revise up our end 2021 EUR/USD forecast to 1.25

- **Rates: Why we want a steeper curve**

We think the US yield curve can steepen further. We also hope it does. A steeper curve gels with a reflation theme and has wider benefits. It can lift Europe, and beyond. The Fed's move to average inflation targeting helps, but guarantees nothing. The curve is smart though; this time last year it was inverted, discounting a recession - we got one. Where next?



Assumptions	Economic impact	Forecasts
<b>Scenario 1</b> (A) + (I) Local lockdowns used as vaccines rolled out during 1H21.	Our Nike swoosh scenario. Governments could decide to extend some of the stimulus measures until mid-2021. Somewhat stronger recovery in 2H21	<b>2020 GDP</b> US: -4.2% Eurozone: -8.0% <b>Markets (end 2020):</b> EUR/USD: 1.20 US 10-year: 0.75%
<b>Scenario 2</b> (B) + (II) Restrictions tightened but full lockdown avoided. Some vaccines rolled out in 1H21.	A variation of our W-shaped scenario with the new dip lasting longer (4Q20-1Q21). Government stimulus extended. 2Q21/3Q21 still subdued.	<b>2020 GDP</b> US: -5.4% Eurozone: -9.3% <b>Markets (end 2020):</b> EUR/USD: 1.12 US 10-year: 0.25%
<b>Scenario 3</b> (C) + (III) National lockdowns return, while vaccine development takes longer than hoped	Our L-shaped scenario but for even longer. Sharp drop in activity in 4Q20, more or less stagnation throughout 2021 and sharp rebound mid-2022	<b>2020 GDP</b> US: -5.7% Eurozone: -9.7% <b>Markets (end 2020):</b> EUR/USD: 1.10 US 10-year: 0.0%

Source: ING

ING global forecasts

	1Q20	2Q20	2020	4Q20	FY	1Q21	2Q21	2021	4Q21	FY	1Q22	2Q22	2022	4Q22	FY
<b>United States</b>															
GDP (% QoQ, ann)	-5.0	-31.7	26	5.5	-4.2	4.0	4.5	3.5	3.0	3.9	3.0	3.0	2.5	2.5	3.1
CPI headline (% YoY)	2.1	0.4	1.2	1.2	1.2	1.5	3.0	2.3	2.3	2.3	2.4	2.3	2.2	2.2	2.3
Federal funds (% eop)	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
3-month interest rate (% eop)	1.45	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
10-year interest rate (% eop)	0.75	0.65	0.75	0.75	0.75	1.00	1.00	1.00	1.25	1.25	1.25	1.25	1.50	1.50	1.50
Fiscal balance (% of GDP)					-20.2					-10.0					-5.6
Gross public debt / GDP					102.4					106.4					106.4
<b>Eurozone</b>															
GDP (% QoQ, ann)	-13.6	-40.3	41.2	6.1	-8.0	4.7	5.0	3.0	2.1	4.8	2.3	2.7	1.8	1.7	2.5
CPI headline (% YoY)	1.1	0.2	0.4	0.3	0.5	1.1	1.4	1.5	1.4	1.4	1.4	1.4	1.4	1.5	1.4
Refi minimum bid rate (% eop)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (% eop)	-0.4	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.35	-0.3	-0.30
10-year interest rate (% eop)	-0.47	-0.45	-0.40	-0.30	-0.30	-0.25	-0.20	-0.20	-0.20	-0.20	-0.20	-0.15	-0.10	-0.10	-0.10
Fiscal balance (% of GDP)					-9.5					-4.6					-2.7
Gross public debt/GDP					104.5					102.8					101
<b>Japan</b>															
GDP (% QoQ, ann)	-2.5	-27.8	15.3	3.6	-5.7	2.3	2.9	4.3	3.1	2.2	1.6	1.4	1.5	1.4	2.2
CPI headline (% YoY)	0.5	0.1	0.2	-0.1	0.2	0.2	0.6	0.8	0.7	0.6	0.8	0.8	0.6	0.6	0.7
Interest Rate on Excess Reserves (%)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
3-month interest rate (% eop)	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
10-year interest rate (% eop)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Fiscal balance (% of GDP)					-17					-9.8					-8.9
Gross public debt/GDP					223.0					229.0					233.0
<b>China</b>															
GDP (% YoY)	-6.8	3.2	2.5	4.0	0.7	6.0	2.0	4.0	2	3.5	2.5	3.5	4.5	5	3.9
CPI headline (% YoY)	5.0	2.6	2.2	1.9	2.9	2.0	2.5	2.5	2.9	2.5	2.8	2.6	2.4	2.5	2.5
PBOC 7-day reverse repo rate (% eop)	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20	2.20
3M SHIBOR (% eop)	1.90	2.00	2.80	3.00	3.00	3.00	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.70	3.70
10-year T-bond yield (% eop)	2.60	2.90	2.95	3.10	3.10	3.15	3.20	3.25	3.30	3.30	3.35	3.40	3.45	3.50	3.50
Fiscal balance (% of GDP)					-6.0					-7.0					-3.5
Public debt (% of GDP), incl. local govt.					110.0					115.0					118.0
<b>UK</b>															
GDP (% QoQ, ann)	-8.5	-59.8	93.2	9.4	-9.4	5.4	2.2	1.7	2.4	6.1	2.3	1.7	2.2	2.3	2.1
CPI headline (% YoY)	1.7	0.6	0.4	0.4	0.8	1	1.4	1.3	1.5	1.3	1	1.2	1.3	1.4	1.3
BoE official bank rate (% eop)	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25
3-month interest rate (% eop)	0.60	0.20	0.10	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.30	0.40	0.40
10-year interest rate (% eop)	0.30	0.20	0.30	0.30	0.30	0.40	0.50	0.60	0.70	0.70	0.70	0.80	1.00	1.10	1.10
Fiscal balance (% of GDP)					-15.0					-7.0					-3.5
Gross public debt/GDP					112.0					110.5					110.5
<b>EUR/USD (eop)</b>															
	1.10	1.13	1.19	1.20	1.20	1.20	1.22	1.23	1.25	1.25	1.25	1.25	1.23	1.20	1.2
<b>USD/JPY (eop)</b>															
	107.0	107.0	105.0	102.0	102.0	102.0	102.0	102.0	102.0	102.0	102.0	103.0	104.0	105.0	105.0
<b>USD/CNY (eop)</b>															
	7.08	7.07	6.78	6.7	6.7	6.65	6.68	6.7	6.73	6.73	6.73	6.73	6.75	6.7	6.7
<b>EUR/GBP (eop)</b>															
	0.89	0.91	0.92	0.90	0.9	0.90	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88	0.88

Source: ING forecasts

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## Three new scenarios for the global recovery's next phase

With the economic rebound from Covid-19 now in full swing, we look at what could be a turbulent path to a full recovery. Our new-look scenarios map out...



Source: Shutterstock

Summer is almost over and the global economy is preparing for an exciting autumn.

How strong will the mechanical rebound be in the third quarter? How strong will the permanent damage be to different economies? Will there be a second wave of Covid-19 and subsequent lockdowns? And, how will governments balance between public health and economic interests? Hopefully, we'll get answers to some of these questions in the coming weeks.

In this second stage, all economic forecasts are again highly dependent on two factors: the further development of the virus and the timing and distribution of any vaccine. To some extent, we are in a similar situation as we were towards the start of the crisis when the main drivers of all forecasts were outside the economic arena.

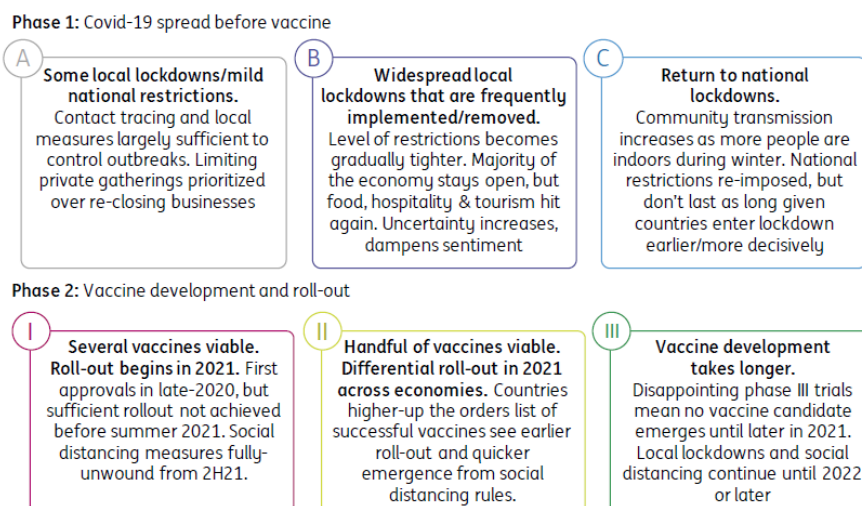
We haven't become virologists but looking at the number of new cases over the summer, it appears that there is a wider discrepancy between infected people and death tolls. The mortality rate is currently much lower than it was from January to April. This can have several reasons: more testing, less social distancing and therefore younger age groups being infected (in Europe, the



average age of new cases has come down by almost 20 years) and a weakening of the virus over time due to summer temperatures or mutation.

Unfortunately, the drop in mortality rate is neither an argument for 'the worst is over' nor for complacency.

## Mapping the next phase of the recovery



Source: ING

## Three new scenarios

	Assumptions	Economic impact	Forecasts
ING base case	<b>Scenario 1</b> (A) + (I) Local lockdowns used as vaccines rolled out during 1H21.	Our Nike swoosh scenario. Governments could decide to extend some of the stimulus measures until mid-2021. Somewhat stronger recovery in 2H21	<b>2020 GDP</b> US: -4.2% Eurozone: -8.0% <b>Markets (end 2020):</b> EUR/USD: 1.20 US 10-year: 0.75%
	<b>Scenario 2</b> (B) + (II) Restrictions tightened but full lockdown avoided. Some vaccines rolled out in 1H21.	A variation of our W-shaped scenario with the new dip lasting longer (4Q20-1Q21). Government stimulus extended. 2Q21/3Q21 still subdued.	<b>2020 GDP</b> US: -5.4% Eurozone: -9.3% <b>Markets (end 2020):</b> EUR/USD: 1.12 US 10-year: 0.25%
	<b>Scenario 3</b> (C) + (III) National lockdowns return, while vaccine development takes longer than hoped	Our L-shaped scenario but for even longer. Sharp drop in activity in 4Q20, more or less stagnation throughout 2021 and sharp rebound mid-2022	<b>2020 GDP</b> US: -5.7% Eurozone: -9.7% <b>Markets (end 2020):</b> EUR/USD: 1.10 US 10-year: 0.0%

Source: ING

## The economics of the vaccine

With a few vaccines now in third-stage trials, a scenario without any vaccine in the next 18 months looks highly unlikely. However, the effectiveness, as well as potential adverse side effects of any vaccine, remain uncertain. [A recent study](#) estimated a vaccine needs to be at least 70% effective if three-quarters of the population is inoculated, a tough task given the accelerated development timeline.

With the prospects of a vaccine increasing, the next question will be how to distribute it. We know that many vaccine producers have already started to produce millions of dosages in parallel to the final trial stages in order to be ready to distribute once their vaccine is allowed to enter the market.

But how many doses will be available remains unclear. And even if there are enough doses available, distributing them will take time.

Also, it is likely that the distribution might not be equal across countries, possibly contributing to a new divergence between developed and developing economies.

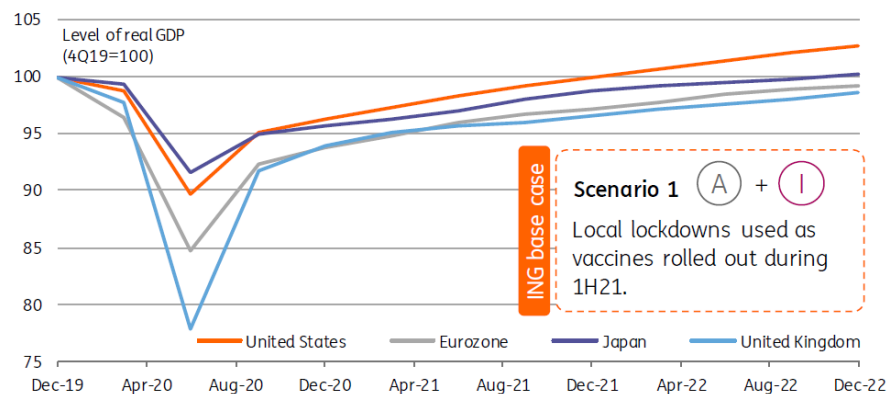
## Our three main scenarios

Looking ahead, there are many ways in which the virus and possible lockdowns and the distribution of any vaccine can play out. We try to capture the most likely outcomes in our latest three scenarios.

Our base case scenario assumes no real flaring up of the virus in the autumn and only local lockdowns. Governments put more intense focus on restricting private gatherings, with limited direct economic impact. Ongoing working from home arrangements and sharply reduced travel mean the virus spread takes longer and is easier to control.

Rapidly developing knowledge of the virus and the best way to treat it in the hospital will also help. Businesses also become more innovative at operating within constraints. That said, we may see a higher rate of business closures in the heavily-affected sectors as firms concede a return to profitability won't be possible for the foreseeable future. Vaccines will be rolled out in the course of the first half of 2021. Social distancing will gradually be reduced in the course of the second half of the year.

### Scenario 1: The path for real GDP

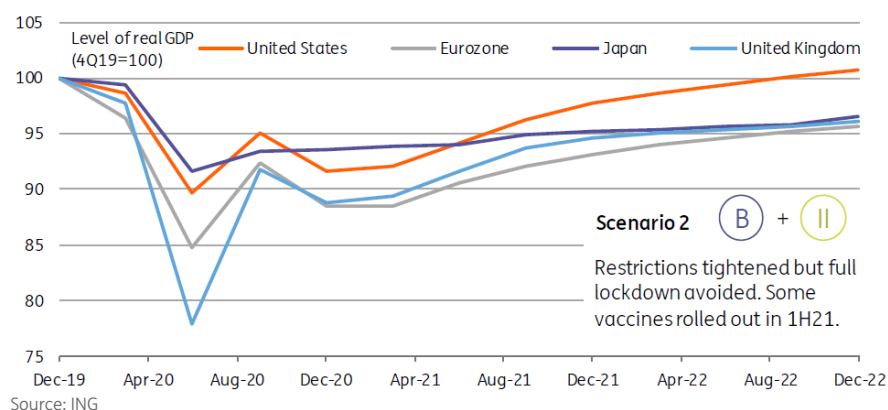


Source: ING

A not so unrealistic alternative scenario is our revised winter lockdown scenario (the W-shaped recovery). Here, the virus becomes more prevalent in the community throughout the winter months as people spend more time indoors. The level of restrictions becomes gradually tighter, potentially involving the re-closure of the food and accommodation sectors, as well as tourism.

Contrary to our previous assumptions, we would not see a return to full national lockdowns but rather a frequent on and off of local and regional lockdowns, substantially undermining business and consumer confidence. Businesses that survived lockdown may not be able to make it through, although it depends how reactive government support becomes when local lockdowns occur. Some vaccines are rolled out in the first half of 2021.

## Scenario 2: The path for real GDP

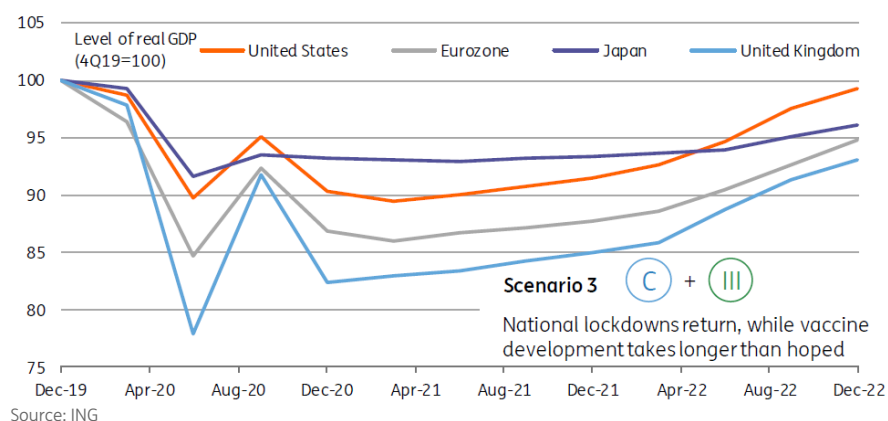


Our worst-case scenario (formerly the L-shaped recovery) remains one in which the virus mutates and spreads again during winter, with the death rate rising significantly.

Consequently, governments bring their economies into full lockdown again. The countries which reacted rather late in March and April are likely to react much faster this time. Therefore, the full lockdown could be shorter than it was this year. However, another wave of full lockdowns could push many businesses into bankruptcy and lead to a sharp increase in unemployment.

Some governments might react with another round of fiscal stimulus but not all will be able to afford it, adding to new tensions, particularly in the eurozone. The development of a vaccine experiences unexpected setbacks and takes until early 2022.

## Scenario 3: The path for real GDP



In our new Economic Monthly, we present the outcomes of these three scenarios. It is possible that situations differ across countries.

For instance, while we think our scenario one best fits the current base case across the developed world, the growth path under scenario two is our new base case for China.

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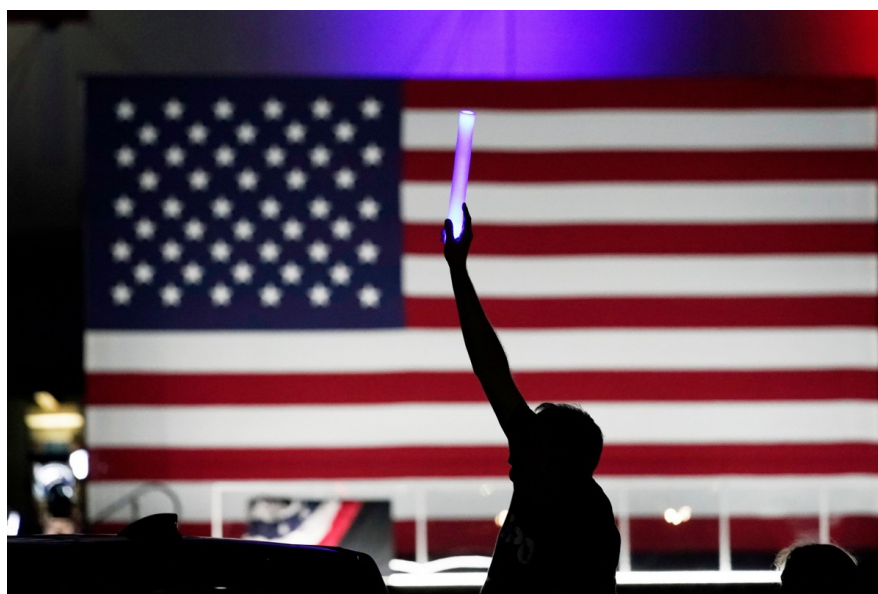
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## US: The surge subsides

High-frequency data suggests that the post-reopening surge in activity began to moderate in July and this process continued throughout August. With the...



Source: Shutterstock

### Signs of plateauing

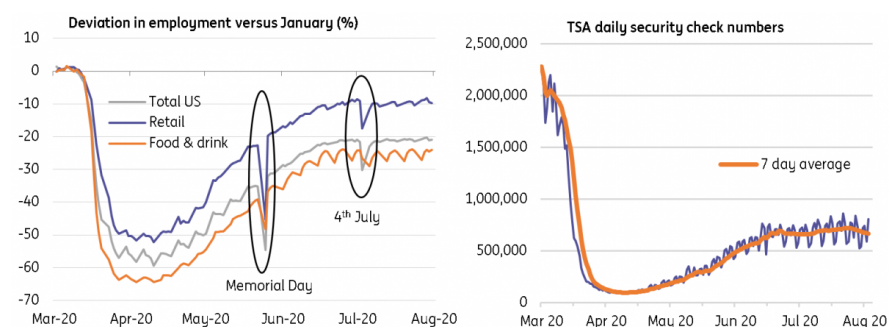
The US economy has rebounded vigorously in the wake of the reopenings that started in May and we have revised up our growth forecast for 3Q20 in response to the stronger tone from the data. Consumer spending is nearly back to where it was pre-pandemic and manufacturing output is bouncing strongly. Meanwhile, equity markets are at new all-time highs on optimism that the US is firmly on the road to recovery.

However, we continue to believe that equity markets are pricing in too positive an assessment over the medium term.

Firstly, consumer confidence has fallen back to cycle lows on the back of health anxieties in response to a recent acceleration in Covid-19 cases. In turn, this has prompted back-tracking from several states, resulting in the reintroduction of containment measures that have had a detrimental impact on many businesses and employment prospects.

Then there is the impact of the reduction in the additional Federal unemployment benefit payment from \$600 to a notional \$400 per week.

## Homebase employment data & TSA security airport check numbers



Source: Macrobond, Bloomberg, ING

## Political and structural risks set to weigh

High-frequency labour market indicators already suggest a plateauing in job creation and the same can be said for credit and debit card transaction numbers. Likewise, there has been a levelling off in passenger flights and hotel bookings. It looks as though the recovery is losing some momentum with 4Q GDP growth likely to be substantially lower than the 26% annualised figure we expect for 3Q.

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*Given the short, medium and long term issues, we continue to think it will be mid-2022 before all of the 1H20 lost output is fully recovered*

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A divisive presidential election campaign could take further steam out of the recovery especially if protests and violence spread to more US cities.

Concern over whether the postal system can cope with a surge of mail-in voting is also a major issue. It could mean that it could be days or even weeks (if there are legal challenges) before we know who has won, which would add an extra layer of uncertainty that could be economically disruptive.

Uncertainties over the timing and efficacy of a vaccine coupled with the threat of a renewed spike in Covid-19 cases in the latter part of the year mean the strains facing the travel, hospitality and entertainment industries will continue. Given these sectors are relatively large in the US this adds to our wariness on getting too excited about the speed of recovery. Then there are the structural effects of a more permanent work from home attitude from workers and what this means for metropolitan centres when there is less consumer footfall.

Given these short, medium and long term issues, we continue to think it will be mid-2022 before all of the 1H20 lost output is fully recovered.



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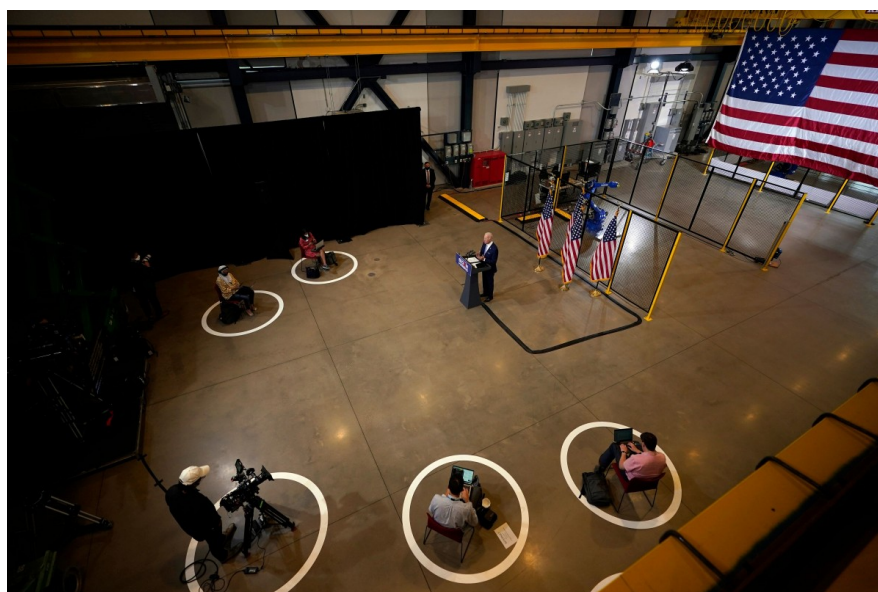
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## US election: Biden's to lose?

Opinion polls suggest Joe Biden has a commanding lead over President Donald Trump, but with two months to go, there are plenty of things that could change...



Source: Shutterstock

Democratic presidential candidate, former Vice President Joe Biden speaks at a campaign event

### Clear dividing lines

The Democrat and Republican conventions show the dividing lines for the 3 November election couldn't be clearer.

The electorate has a choice of re-electing president Donald Trump who is standing on a ticket of lower taxes, less regulation, less immigration and an "America First" worldview. Or, alternatively, it could opt for Democrat challenger Joe Biden, who represents a more internationalist agenda with more spending, more taxes and more regulation.

Major disagreements over the government's Covid-19 response, the economic support packages and the Black Lives Matter movement add further fire to what seems set to be one of the most divisive electoral battles in US history.

### Biden in front

At present, opinion polls show Joe Biden has a seven-point lead nationally, which would equate to

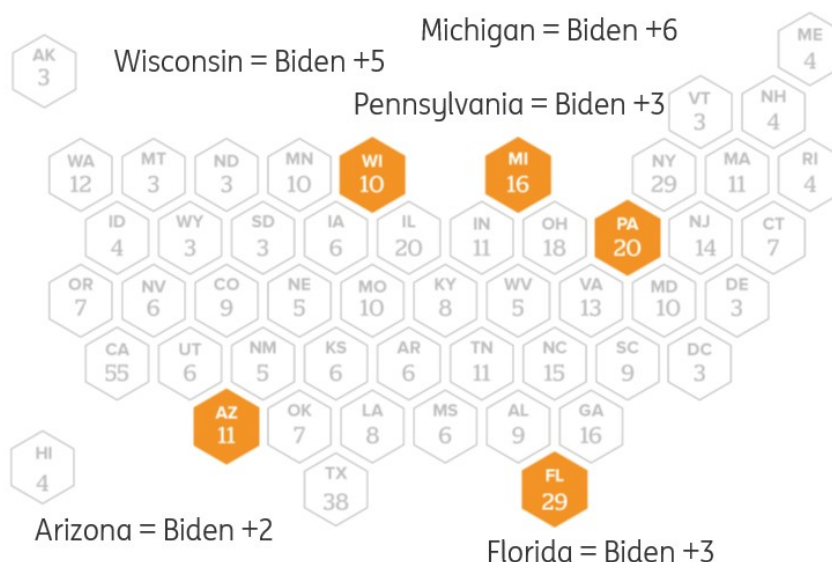
him winning around nine million more votes than Donald Trump.

However, the electoral college system means it is a state by state battle, but one which has failed to keep pace with population change. It gives greater weight to rural central states that tend to be more supportive of Trump and less weight to highly populous coastal states that tend to lean Democrat. This cost Hillary Clinton four years ago, having won 2.8 million more individual votes than Trump yet falling well short in the electoral college.

However, the polls currently show the key battleground states that will determine the outcome of the election are all favouring Biden. Polls also suggest that the Democrats will retain control of the House and there is a decent chance that they will make the required net gain of three Senate seats to make it a clean sweep.

## The swing states are key and Biden leads in all 5

The numbers underneath each state refer to the number of electoral college votes awarded. To become president the victor needs at least 270 of the 538 available. Biden +5 represents his lead over Donald Trump in the latest state opinion poll



Source: ING, Real Clear Politics poll data

## Tax and spend ahead?

As we outline in our recent [note](#), in such an event, we would likely see big infrastructure spending plans coming through next year with subsequent corporation, capital gains and income tax hikes for the wealthy over following years to try to bring the deficit under control.

The dollar and equities may not initially like it but should better-balanced growth emerge and the budgetary position improve, as it did under Clinton in the late 90s, Biden could ultimately prove to be a dollar positive.

## No guarantees

Biden cannot rest on his laurels though.

Covid-19 means we are likely to see more people than ever before opting for mail-in (postal) voting, yet there is concern that the US Postal Service may be unable to deal with the potential scale. This could pose problems for Biden with an NBC News/Wall Street Journal poll suggesting only 11% of Trump supporters plan to vote by mail versus 47% for Biden supporters.

We also have to remember there are another two months to go, with debates still to come. How the economy and the unemployment situation develops between now and then will be critical, as will, of course, the number of Covid-19 cases and a potential vaccine.

Nothing can be ruled out yet.

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Article | 3 September 2020

## Eurozone: The rebound continues...for now

The eurozone is still on track to see a very strong third-quarter growth figure. However, recent indicators signal some deceleration. Inflation is...



Source: Shutterstock

ECB President Christine Lagarde (R) attends a press conference at the ECB headquarters in Frankfurt, Germany

### Beyond the third quarter

We've pointed it out already many times: when production rises from nearly nothing to something, you've got strong growth. That is what is happening now in the third quarter, as the easing of the lockdown measures and the reopening of businesses creates this effect. The fourth consecutive strong increase of the European Commission's economic sentiment indicator in August clearly points towards robust third-quarter growth, potentially double-digit growth figures.

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*When production rises from nearly nothing to something, you've got strong growth*

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At the same time, you shouldn't be blinded by the strong 3Q figures because we believe things will become a bit more difficult after the initial strong rebound. Some indicators actually already signal a deceleration in the growth pace. As such the flash composite PMI fell in August and also the Eurocoin indicator lost further momentum last month. Of course, a flareup in the number of Covid-19 infections over the summer has made it very clear that as long as there is no effective vaccine, growth will be handicapped.

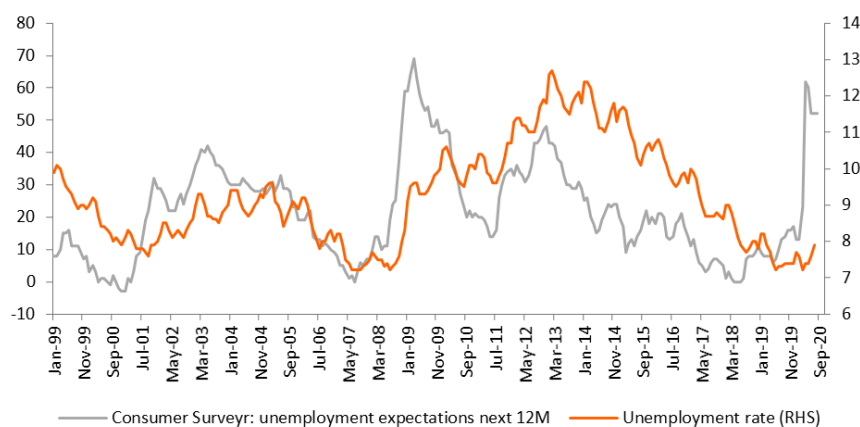
Spain seems to be the unfortunate example of this phenomenon, as the tourist season has been a major disappointment in the wake of a second Covid-19 wave. But France, too, has seen any improvement lose steam recently. In both countries, the manufacturing PMI actually fell below the 50 point threshold in August.

## Second round effects

There is also the fear of negative second-round effects once the current recession starts to be reflected in a swelling number of unemployed (the unemployment rate already rose to 7.9% in July). Fortunately, most countries have decided to prolong the temporary unemployment schemes – in Germany even to 24 months – to limit the negative shock to disposable income.

But even then, we cannot exclude higher precautionary savings dampening consumption. We stand by our 8.0% GDP contraction this year and pencil in a 4.8% rebound in 2021, albeit on the assumption that a vaccine will be widely available in the first half of next year. So there is clearly a downward risk to this forecast.

## Unemployment fears



Source: Refinitiv Datastream

## Inflation jitters

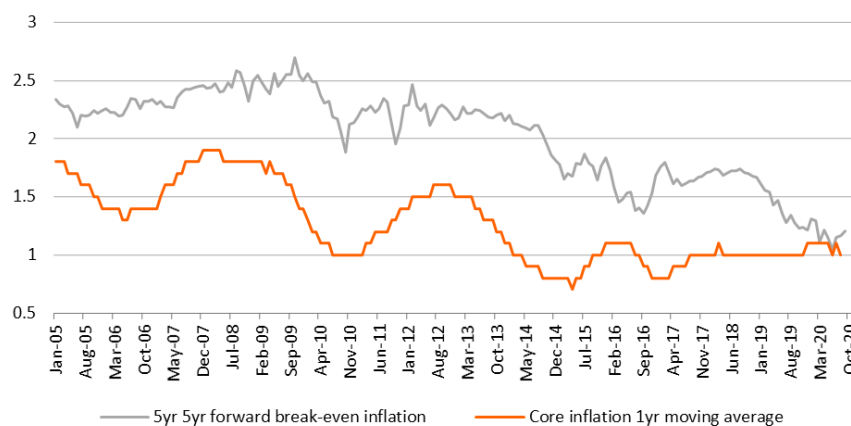
July and August inflation figures were distorted by the VAT cut in Germany and a fragmented sales season. By just taking the average of both months it seems clear that underlying inflation remains anchored around 1%. To be sure, if the German VAT cut is reversed in January next year as planned - though this is not a done deal yet in an election year - inflation would be pushed upwards. But even then eurozone inflation is unlikely to top 1.5%.

Moreover, the strong euro is likely to temper any upward price pressure. Indeed, in the August survey from the European Commission, selling price expectations already softened somewhat both



in industry and services, a potential consequence of the loss of competitiveness on international markets. According to [ECB research](#), a 10% change in the euro exchange rate (which we are close to), results in a 0.4 percentage point change in inflation.

## Inflation expectations anchored at 1%?



Source: Refinitiv Datastream

## ECB cannot lean back

With financial market tensions having abated on the back of the forceful actions of central banks worldwide, the European Central Bank is becoming a bit more relaxed. This led several members of the governing council to suggest that the amount available in the PEPP should not necessarily be spent entirely.

*Some PEPP extension is still possible*

However, Chief Economist Philip Lane made it clear in his Jackson Hole address that “*an intense temporary phase of additional monetary accommodation*” was necessary to get inflation back on track.

With the euro strengthening, this task will be further complicated. Therefore we believe not only that the PEPP envelope will be spent entirely, but on top of that, some extension is still possible. However, a decision on this matter will most probably have to wait at least until December.

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Article | 3 September 2020

## Eurozone: Short-time work provides cushion to double-dip worries

Worries about a double-dip recession are increasing in the eurozone as disappointing survey data for August provides a reality check on the pace of...



Source: Shutterstock

As quick as it came, it went away again: optimism about the eurozone recovery.

After stellar recovery signs in May and July, August survey data indicates that the speed of the recovery has dropped significantly. The PMI even fell back to a reading just above 50, which indicates stagnation of output growth compared to July. This sudden reversal begs the question, is a double-dip recession in the making? To put the recent weaker survey indicators into perspective, it is important to keep in mind what is happening in the economy at the moment.

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*The rebound effect is wearing off*

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After the unprecedented period of lockdowns, the eurozone economy has reopened, which has caused many parts of output to recover. This means that compared to the bottom in activity which occurred in April, we see a strong bounce back, which happens almost mechanically as businesses

reopen from a mandatory shutdown. As a consequence, the eurozone economy will experience strong growth in the third quarter even if economic activity were to freeze at its end of June level. However, this rebound effect is wearing off. And unless all Covid-19-related restrictions are dropped, growth should slow significantly in the fourth quarter. This raises questions about whether a slowdown could even result in another decline in output.

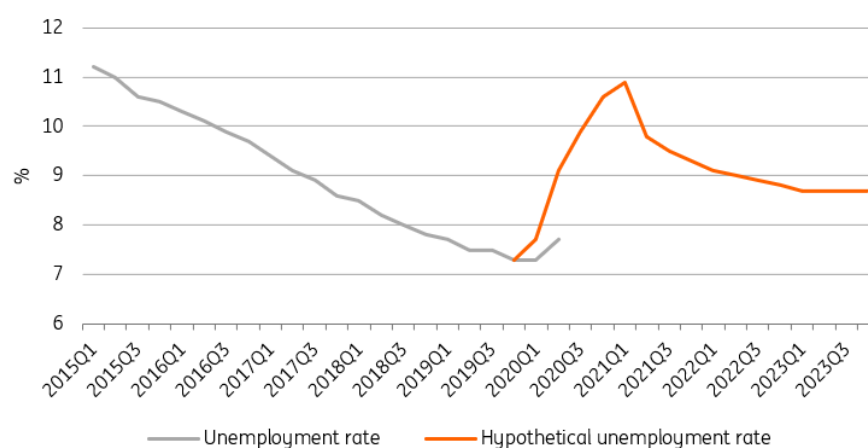
## Short-time work schemes to the rescue

In our view, the risk of a double-dip is increased by the so-called 'cliff' effect, i.e. the ending of government support schemes, particularly at a time when the risk of a second lockdown is still possible. One of the most effective government support programmes, without doubt, has been the short-time work scheme. While the unemployment rate has risen markedly in the US, it has only gone up in the eurozone from 7.1% in February to 7.9% in July. Amid an unprecedented decline in economic activity, short-time work programmes have ensured continued income for the large majority of eurozone consumers.

These programmes follow the successful model of Germany in the 2008 crisis when it implemented its own version called Kurzarbeit. Back then, the programme helped Germany recover from the recession quite quickly and this has served as a policy model for other countries. The EU encourages the policy by providing cheap loans to fund the programmes, which can be costly. While it is difficult to estimate the precise effect of these schemes on the unemployment rate, we can estimate a counterfactual unemployment rate to see how far the rate would have run up without short-time work during this unprecedented economic shock.

## Cyclical factors would cause unemployment to top out around 11%, but the curve is being flattened

Macrobond, ING Research



Our estimates – as you can see in the chart above – suggest that unemployment would have been around 10% without the programmes and that unemployment would run up to around 11% in the first quarter of 2021 before starting to decline again, in a scenario without a new round of widespread lockdowns. That would already be a lower peak than the 12.1% reached in 2013 at the height of the euro crisis, but as short-time work schemes flatten the curve, it is likely that the peak will be somewhat lower. At the same time, it is also likely that the peak in unemployment will be

reached at a later point in time than it would have done without the short-time work schemes.

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### *Lower unemployment rate provides a comfortable cushion for domestic demand*

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This lower unemployment rate provides a comfortable cushion for domestic demand in the recovery phase but, of course, the schemes will end at some point. Worries about a 'cliff-edge' scenario when schemes end and layoffs follow seem legitimate and also concern the European Central Bank, as this was mentioned in the minutes of the last ECB meeting. As many schemes are set to end around the turn of the year, expectations of increased unemployment are realistic, which increases the risk of a double-dip recession.

The good news is that policymakers are aware of this risk and the European Commission is offering financial assistance to member states through its borrowing programme (SURE), as mentioned above. The take-up for this programme is already substantial, with Italy, for example, requesting €28 billion from the fund thus far. This allows extensions of the programmes, which have been seen in quite a few large countries. France and Germany have extended into 2022 while the Netherlands has extended in a less generous form until mid-2021, lowering the chances of a cliff-edge scenario on the labour market around the turn of the year.

### **Don't rule out a double dip altogether, it's not an unlikely scenario**

Still, while eurozone governments are determined to do everything they can to avoid a real double-dip recession, a small or more technical double-dip is not unthinkable.

Our current expectations for third-quarter growth are around 10% quarter-on-quarter, which is caused by the reopening of the economy and in part fuelled by catch-up spending. For some products, the drop in spending through the months of April and May could be recovered fully in the first months of reopening. But once that effect is over, a dip could be in the making as the bounce in spending is unsustainably high. That would not reflect the start of the next recession but merely bring the recovery back to its original trend. Alternatively, in a scenario with new lockdowns, a double-dip would probably be the least of the eurozone's worries.

So while government support, especially in the labour market, is boosting the economy even as the recovery slows, **the chances of a double-dip are still very real**. For now, it looks like it may be enough to return the economy back to the level of output seen prior to the crisis, albeit at a slower pace than in the first few months.

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# UK: What Brexit means for the economy in 2021

We think it's unrealistic to expect a sudden plunge in GDP once the transition period ends. But whether there's a deal or not, the change in UK-EU...



Source: Shutterstock

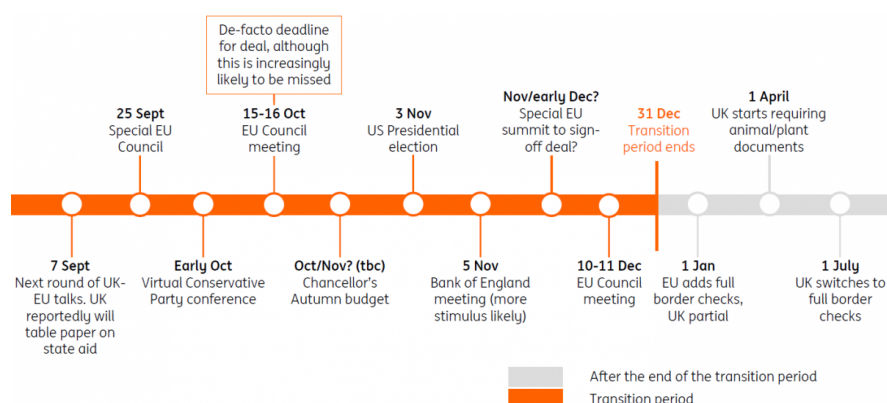
Britain's prime minister Boris Johnson, left, elbow bumps Lead Nurse Marina Marquis, during a visit to Tollgate Medical Centre in Beckton, East London

## Time is running out on trade talks

There are now less than four months to go until the end of the post-Brexit transition period, and with negotiations stuck in deadlock, there are renewed fears that there won't be a trade agreement in place to replace it. The de-facto October deadline for negotiations to be wrapped up looks increasingly likely to be missed.

But what does all of this mean in practice for the economic outlook in 2021?

## The latest Brexit timeline



Source: ING

## A sudden plunge in GDP next year seems unlikely

A common hypothesis is that we should expect a sharp and sudden drop in GDP in early 2021. After all, even with a free-trade agreement (FTA) in place, the change in UK-EU trade terms will be significant.

For that to happen though, we'd need to see a plunge in consumer spending, which makes up almost two-thirds of the UK economy. This currently seems unlikely. Evidence from the Brexit deadlines in 2019 suggested consumers were unfazed by the prospect of 'no-deal', and unlike businesses, there wasn't much evidence of stockpiling. Toilet rolls remained in plentiful supply, anyway.

Instead, the path for spending over the winter will be much more heavily determined by developments in the jobs market, and of course how the government's support package evolves once the furlough scheme ends in October.

## Costs will go up for businesses, and that'll keep the brakes on the recovery

That's not to say there will be no impact once the transition period ends, and we don't think it's true to say that the enormity of the Covid-19 hit will make the Brexit effect indiscernible.

Firms will see their costs rise once the transition period ends, and this has the potential to compound the damage already done by the pandemic. These new costs are not necessarily the same as those already being incurred as a result of Covid-19.

Take the car industry, where production fell by 70% during the second quarter. Cars make up 7% of UK exports to the EU and would face a 10% tariff if there's no free-trade agreement in place this year. Even if there is a deal, it seems reasonable to expect some initial disruption at the ports, and that's likely to raise transport costs and slow down production. Companies could raise stockpiles again to compensate, but with cashflows already under heavy pressure as a result of the pandemic, and warehousing space increasingly occupied ahead of Christmas, this is likely to be a very unattractive option.

The switch to new UK-EU trade terms will also hit several sectors that have been among the least

affected by Covid-19. Agricultural production slipped by less than 5% during the second quarter, but is the most vulnerable sector to tariffs, often in excess of 30%. The sector will also be among the most impacted by new border-related bureaucracy, with spot checks disproportionately focused on animal and plant certification.

## A deal would reduce some, but not all, of the burden

The agreement of a trade deal would admittedly ease (but not eliminate) some of these new frictions. And despite the current standstill in negotiations, we think that a basic FTA is still narrowly the most likely scenario this autumn.

If that's the case, tariffs would be avoided (although firms would still need to prove the origin of the product to qualify). Both sides might also agree to reduce the frequency of health checks on animal/plant products at the border, and could also look at introducing trusted-trader schemes, all of which could help reduce some of the pressure on the ports.

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*Despite the current standstill in negotiations, we think that a basic FTA is still narrowly the most likely scenario this autumn*

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And while a trade deal won't do much for services, it probably raises the chance of an EU decision on financial equivalence and data sharing.

There's also still a lingering chance that a deal would unlock some form of additional, bare-bones transition period to help businesses adapt. This would be much more basic than the current environment and would be more legally-complex and time-consuming to agree. But an agreement to, say, allow the UK to remain in a customs union for an extended period, in exchange for budget payments, would potentially ease some of the initial bureaucratic burdens on firms. This could be particularly beneficial for UK traders sending goods to the EU (the UK government is already planning some unilateral steps to stagger the initial changes for importers).

How likely is some form of additional transition, or 'off-ramp' as some are calling it? The jury's still out on that one.

[For more info on ways both sides could facilitate and extended, but more limited, transition period, we'd recommend reading this paper by the Institute for Government](#)

### Expect more stimulus from the Bank of England

Still, the key point is that, with or without a deal, the bureaucratic and cost burden on firms will be materially higher next year.

So while we're unlikely to see a sudden hit to GDP from Brexit in the early stages of next year, the additional strain on firms will inevitably put the brakes on the overall post-Covid recovery. The consequence may be that the spike in unemployment we're likely to see (potentially 8-9% by year-end) persists for longer, and broadens out to a wider range of sectors than might have otherwise been the case.

For the Bank of England, this is just another reason to expect a further round of stimulus in November. We suspect this will involve more quantitative easing, but the jury is still out on negative rates. We think policymakers might initially be more inclined to adjust the interest rate on the term-funding scheme (designed to encourage lending to small businesses) as a first step.

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Article | 3 September 2020

## Central and Eastern Europe: No deflationary threat here

Growth in the CEE region is picking up in line with the eurozone, but in contrast, inflation remains above target. Central banks are unlikely to respond...



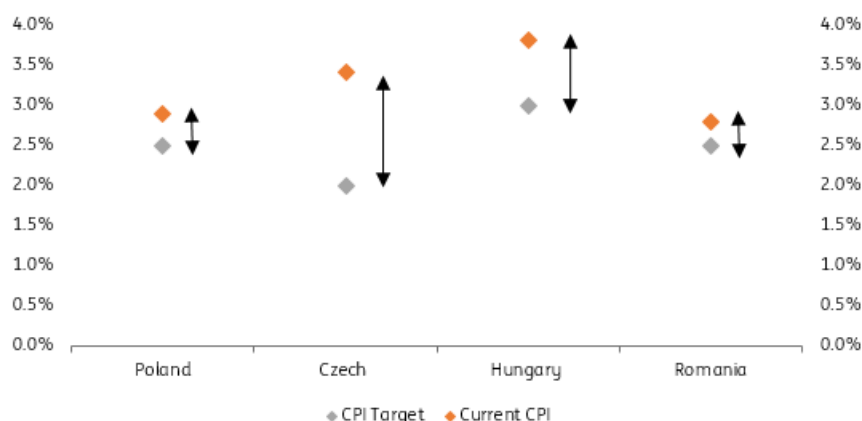
Source: Shutterstock

### Growth on a recovery path (a bit like the eurozone)

The post Covid-19 recovery in central and eastern Europe continues, in line with the general eurozone trend.

The worst is behind us and in contrast to the first two quarters, the third and fourth quarters should see positive growth, with activity rebounding particularly strongly in the third quarter. Indeed, the latest bout of [CEE August Manufacturing PMIs](#) continues to point towards optimism in the manufacturing sector in the second half.

**Figure 1: CEE inflation readings remain above target**



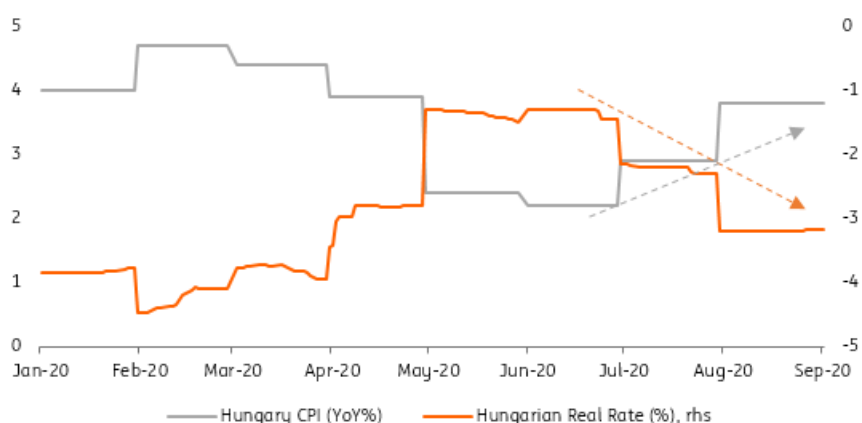
Source: ING

### Inflation remains rather high, unlike in the eurozone

While the CEE economic recovery is following the trend of the eurozone, this is not the case for inflation. The eurozone CPI remains subdued and the August reading dipped into negative territory, but the CEE region has for some time faced the opposite problem – above target CPIs, as you can see in the chart above, with price pressures being particularly high in the Czech Republic and Hungary, when compared to their target.

Such a meaningful divergence vs their main trading block seems to be caused by factors such as a tight labour market and associated strong wage growth (due to retention schemes, we have not seen a meaningful rise in unemployment yet, with CEE unemployment rates remaining low) or possibly quicker and higher FX pass-through (note the meaningful depreciation, though temporary, in CE3 FX during the peak of the Covid 19 crisis).

**Figure 2: HUF real rate deteriorated recently**



Source: ING, Bloomberg

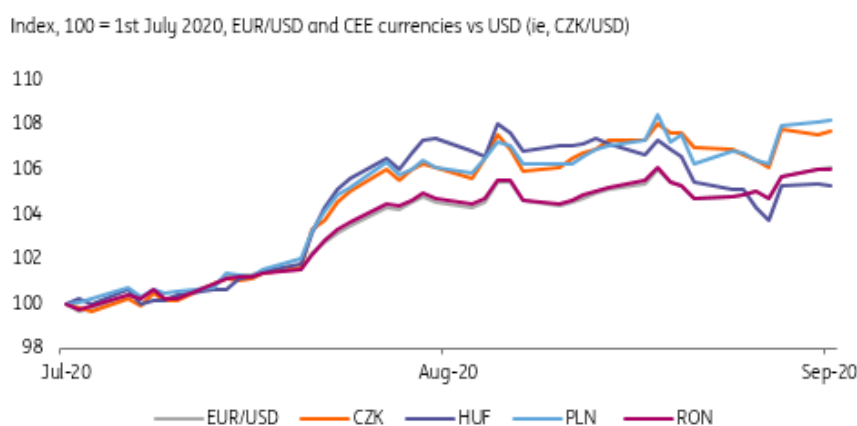


## Limited response from CEE central banks, with easing bias firmly in place

Despite the above target CPI, we don't expect local central banks to respond with tighter monetary policy, with a larger weight likely put on supporting domestic economies. Local inflation is expected to decelerate anyway into the year end (this is already underway in Poland). If anything, the easing bias of CEE central banks should remain in place.

The National Bank of Hungary increased the pace of its weekly quantitative easing purchases from HUF 15 billion to 40 billion last month and we still expect the National Bank of Poland to extend its QE into 2021. The Czech National Bank should remain firmly on hold, with unconventional easing (as has been the case in Poland and Hungary) currently being an ultra-low probability event.

### Figure 3: CEE FX boosted by the rising EUR/USD



Source: ING, Bloomberg

### CEE FX reaping the benefits of the surging EUR/USD

Although the recent period of above-target CPI meant fairly negative real rates in the CEE region, this has not been overly negative for local FX (with the exception of HUF where we witnessed a sharp jump in CPI and fall in the real rate recently - Figure 2). As the CEE currencies are the only emerging market region benefiting from the rising EUR/USD (Figure 3), the fiscally stable CEE FX remains attractive as an EM FX overlay to bullish EUR/USD positions.

The Czech koruna remains our top pick. The gradually improving PLN real rate means there is less scope for Poland's zloty to underperform within the region. As for Hungary's forint, we expect the recent underperformance to fade as inflation has likely peaked and should move towards the 3% target by year-end. But as the real rate is now the most negative within the region, the scope for the forint to outperform its peers, as was the case in early summer, has narrowed considerably.

# China: Revising GDP and yuan forecasts

China's recovery has started and looks sustainable because domestic demand has returned amid fewer Covid-19 cases. This leads us to revise our GDP...



Source: Shutterstock

Woman wearing a face mask to help curb the spread of Covid-19 as her friends prepare to set up a picnic cloth on a scenic mountain in Yanqing, outskirts of Beijing, China

## Domestic driven demand

Recent data shows that domestic demand in China has risen, creating more jobs. Joblessness, by our estimate, is still high at around 7%, but it has fallen from a peak of 10% when Covid-19 cases were still high.

Due to low Covid-19 cases in China, the government is now allowing cross-provincial travel and the policy has helped support retail sales. New orders in PMIs from manufacturing to non-manufacturing have also increased.

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*Net exports should no longer be the sole engine of GDP growth in 3Q20*

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Industrial profits grew 19.6% year-on-year in July. Though we anticipated that some profit growth would follow on from low energy costs, this data also implies that the speed of GDP growth could also increase.

We don't think GDP growth in the third quarter will rely on big net export growth of 8.8% YoY as in 2Q20. The surge in 2Q20 was mainly a result of very weak import growth. As domestic demand picks up, we expect import growth will also pick up. Net exports should no longer be the sole engine of GDP growth in 3Q20.

## Revising GDP forecasts

We have revised our GDP growth forecast for 3Q20 to 2.5% YoY from 0.5% YoY, due to better than expected data. But growth in 4Q20 is revised down a bit from 5% YoY to 4% YoY due to potential escalation in the technology war.

The full-year forecast for GDP is 0.7% up from the previous 0.5%.

## Lockdown scenario

China has had frequent lockdowns due to its vast geographical area and a policy which prefers to lock down early rather than adopt a wait-and-see approach.

During these lockdowns, the strictest social distancing measures have been applied. This means that China falls into our scenario B as a base case rather than A, which is less strict when handling Covid-19 cases.

In Hong Kong, scientists reported the case of a man who became reinfected with Covid-19 after travelling to Europe - the first documented case of reinfection in the world. This means a single vaccine may not be able to stop people from getting Covid-19 again, especially when travel restrictions are relaxed. With China now allowing cross-provincial travel, this could mean the country needs to see the development of several vaccines to keep Covid-19 at bay.

## USD/CNY forecast at 6.7

As a result of the quick softening in the US dollar, our previous USD/CNY forecast is out of scope.

We believe the weakness of the dollar will continue irrespective of who wins the US presidential election, which means a further strengthening of the CNY against the dollar is more likely than a flat trend from now to the end of the year.

We are revising USD/CNY to 6.70 from the previous 6.97 at the end of 2020.

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Article | 3 September 2020

## Asia-Ex China: Slow recovery

Shinzo Abe's resignation as Japan's Prime Minister has grabbed the headlines this month. Elsewhere, recovery continues across the region, with...



Source: Shutterstock

Japanese prime minister Shinzo Abe bows to the national flag as he announces his resignation due to health concerns.

### Abe's resignation has not hurt the yen

The news of the month in Asia excluding China is the resignation of Japan's PM Shinzo Abe on health grounds.

Abe has been Japan's leader since 2012 and was the country's longest-serving Prime Minister. This latest stint was his second as PM – he also took the role briefly between 2006 and 2007. The coming days will see potential candidates jockeying for position.

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*Markets are already registering they don't necessarily see a new round of stimulus plans coming from the Bank of Japan*

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And while this might ordinarily have you wondering about a new round of stimulus plans to provide a smooth initiation period for any incoming PM, markets are already registering that they

don't necessarily see this as coming from the Bank of Japan, given several candidates have been open critics of Japan's central bank in the past. This is one reason why the Japanese yen rallied on the Abe news when normally, you would have expected it to depreciate.

Furthermore, with Japan claiming a 40% (GDP equivalent) fiscal stimulus in response to Covid-19 (probably the world's highest on "claimed" figures), this will also be hard to top.

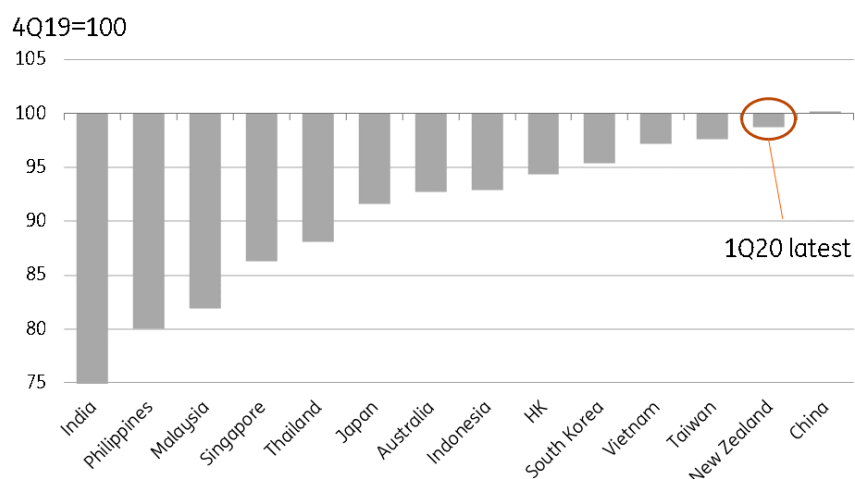
## North Asia leads the pack

Elsewhere in the region, GDP figures have been drifting out, with more just out from Australia (-7.0%QoQ).

These show the extent of the Covid-19 damage, with India along with ASEAN countries, Philippines, Malaysia, Singapore and Thailand, at the bottom of the pack (measured in the chart below as an index where pre-Covid 4Q 2019 = 100), and North Asian economies, such as Japan, South Korea, and Taiwan (which probably benefit more from economic and geographic proximity to fast-growing China) registering smaller declines.

The relative outperformance of semiconductor demand is also disproportionately helping these economies. New Zealand is still to register 2Q20 GDP.

## Asian GDP (4Q 2019 = 100)



Source: CEIC, ING  
Asian GDP

## Second wave back under control

Monthly data on industrial production, either the figures themselves or the manufacturing PMI series (where no hard data has yet been released), are painting a patchy picture for output in 3Q20. On balance, it looks as if the recovery continues, but it isn't robust across the entire region and is more consistent with the sort of slow recovery through 2020 and 2021 that reflects our baseline case, than any sort of V-shaped notion.

Helpfully, recent Covid-19 spikes, registered in countries such as South Korea, Australia, and New Zealand, now seem to be coming back under control again, thanks to swift actions by the respective authorities, though the second waves are likely to keep re-opening at a very cautious

pace, weighing on the pace of recovery in 3Q and 4Q20.

Recent experience also shows how easily and rapidly Covid-19 can get out of control and is a lesson against complacency in other countries.

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# FX: The dollar bear trend has only just begun

US fiscal policy paralysis and a change in monetary policy strategy from the Federal Reserve make the case for the dollar bear trend extending well into...



Source: Shutterstock

## Negative real yields drive the dollar

If real interest rates are one of the best gauges of monetary policy settings then US monetary conditions are now the loosest they have been since 2012. These loose conditions have led to accusations that the dollar is being deliberately 'de-based'. That term seems a little too pejorative, but what is clear is that the Fed has its foot firmly on the reflationary accelerator and a weaker dollar is part of the preferred monetary policy mix at this early stage in the recovery cycle.

Below, two charts highlight the impact of negative US real yields on i) the dollar and ii) portfolio flows into emerging markets. Arguably, the DXY should have traded weaker into 2012/2013 on the back of the decline in US real yields. Yet that period marked the height of eurozone debt tensions. What is different now is a period of relative calm in European politics – presenting an opportunity for the EUR/USD rally to extend into 2021 as the Fed keeps rates lower for longer.

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*We see the dollar downtrend extending through 2021*

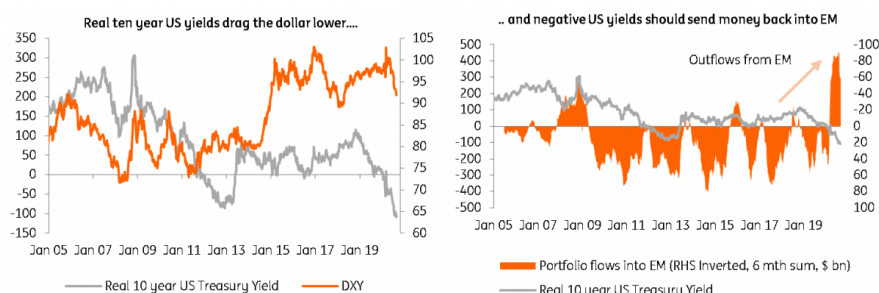
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Equally, the trend towards more negative US yields has typically created a positive environment for portfolio flows into emerging markets. This year's exodus of capital from EM has been far more aggressive than that seen during the 08/09 financial crisis. And if global policymakers can keep 'V'-shaped hopes alive and second wave fears in check, we expect that the return of capital into EM will be a story that runs deep into 2021 – adding to the benign downtrend in the dollar.

For the above reasons, we see the dollar downtrend extending through 2021 and raise our end year 2021 EUR/USD forecast to 1.25 from 1.10 previously.

## Negative real US yields hit the dollar and send portfolio flows back to EM



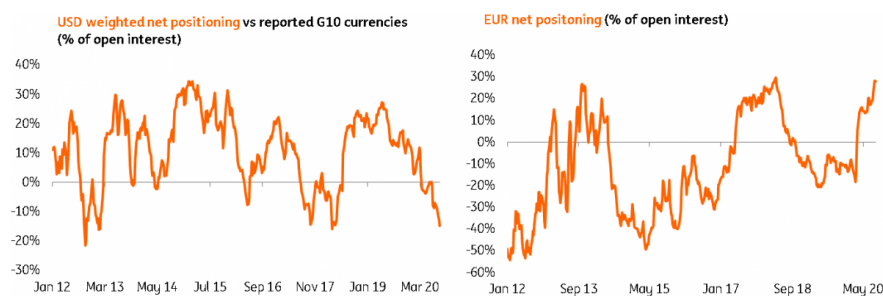
Source: Bloomberg, ING

## Positioning and US elections muddy the water into year-end 2020

The reason we are not raising our 1.20 year-end 2020 forecast is largely on the back of a speculative market already heavily on board with these themes. Net dollar positioning is as short – and EUR positioning as long – as it was in March 2018.

Heavy one-way positioning normally warns of a correction. Yet the febrile atmosphere running up to the November elections and the prospect of a contested election result warns that a risk premium could be built into US asset markets. It would be a rare occurrence, but a 'sell US' investment thesis may well emerge and trigger a rare period of positive correlation between the dollar and US equity markets. USD/JPY could be pressing the 100 level in such an environment.

## Positioning: Speculators are very short USD... and long EUR



Source: CFTC, ING

## Author

### Chris Turner

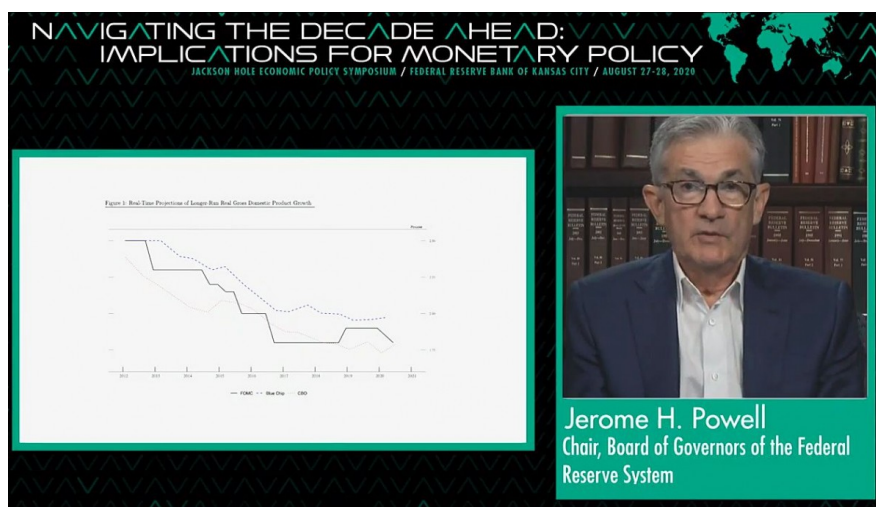
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## Rates: Why we want a steeper curve

We think the US yield curve can steepen further. We also hope it does. A steeper curve gels with a reflation theme and has wider benefits. It can lift...



Source: Shutterstock

A handout screen grab made available by the Federal Reserve showing Jerome Powell, Chair of the Federal Reserve speaking during the virtual annual symposium in Jackson Hole

### Why the yield curve is such a shrewd predictor

Remember this time last year? The yield curve had inverted (in particular on the 2/5yr segment); the talk of the town was of recession of some description coming down the tracks. It might take a year or maybe two, but it was coming.

At that point, there was no clear and obvious catalyst to a recession. The macro numbers were just about holding up, but real yields were falling, and the money market curve was inverting - lower rates were being discounted.

Roll on six months and we found ourselves in the midst of the biggest collapse in economic activity in modern times.

When the 5-year rate starts to trade below the 2-year rate we know things are not good. The 5-year is telling us that the 2-year needs to be lower. That, in turn, implied that the Federal Reserve needs to cut rates, and if the Fed is cutting rates we are probably heading to a recession, or at the very least, sub-trend growth.

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*The curve did not predict Covid, but Covid did bring on the recession that was being discounted in the inverted yield curve*

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That is the telegraphic value of the simple shape of the curve, and especially along this segment. But that is where things get complicated, as the curve today has quite a different profile, and is telling us a very different story.

## What is the curve telling us now about the future?

The good news is the 2/5yr segment is no longer inverted. The bad news is it is almost flat as a pancake, now at just above 10 basis points. That is quite a flat 2/5yr segment, against a backdrop where the Fed has completed its rate-cutting cycle (as they do not plan to go negative). Some curve steepness is good as it predicts an eventual uplift in rates and crucially does not anticipate a double-dip recession. It predicts a slow, but eventual recovery

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*Some curve steepness is good as it predicts an eventual uplift in rates*

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But the very flat 2/5yr segment is also a function of forward guidance, as the Fed has no intention of hiking rates in the coming few years, and the relatively flat 2/5yr segment is fully endorsing this stance.

Beyond five years, we see a steeper curve. The 5/10yr is in the 40 basis point area (a tad steeper in bonds, but flatter in swaps), and the 10/30yr spread is similar in swaps and steeper in bonds.

Bottom line, the curve pivots steeper from 5 years and longer. This is good. It paints a picture of reflation, eventually. That's the current discount.

## And why average inflation targeting actually matters

The fact that the Fed is now targeting average inflation is a good thing, as it means they will not be super pre-emptive if a recovery of sorts is sniffed out in the coming years. Theoretically, this could provide the economy with a better chance of achieving escape velocity from the Covid-19 impacted years.

The cost, other things being equal, could be higher inflation than otherwise would have been obtained. This matters for bondholders, as inflation is their biggest enemy - it erodes the value of fixed coupon and redemption payments, and especially for ultra long-dated exposures.

Higher long-dated yields are required as compensation.

That is why the curve should steepen further from the long end, and indeed why we would like to see the curve steepen - it implies a market discount for some reflation of the

economy. Far better this than a slump back to a deflationary tendency. Liking what a steeper curve implies is not enough though, we need to believe in it.

We do, but don't expect a dramatic steepening as contemporaneous macro angst remains too deep and dominating for now.

We will continue to monitor this space very carefully.

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