

# Monthly Economic Update

## A cruel summer

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## Introduction

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### US: Forget the "V"

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### Eurozone: Better, but the fear factor remains

- *After the historic GDP contraction in 2Q, Eurozone economic figures have improved, though the flare-up of Covid-19 infections has placed a burden on the recovery*
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### China's tech war with the US has made us revise our yuan forecast

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### FX: King dollar loses its crown

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## Introduction



It's a cruel summer.

Back in 1984, Bananarama were singing about hot summer streets, unsuccessful attempts to smile and being left on their own.

A feeling many will have these days when wanderlust has to be subdued and the nearby lake has to make up for a sandy coastal beach. The summer is also cruel as it finally added numbers to the Covid-19 crisis. For most economies, the GDP data for the second quarter followed the pattern of 'worst quarter since x years for country y'. We only had to fill in the numbers.

In all honesty, as severe as these GDP readings were, they are yesterday's story. In fact, they are a painful illustration of the costs of a lockdown. The longer and the stricter a lockdown, the more severe was the impact on the economy. This pattern nicely explains the differences across the Eurozone. The (too) early lifting of lockdown measures in the US is also the main reason why the contraction was somewhat less severe than in the Eurozone. At the same time, China's recovery continued. The fact that Chinese exports in June surprised to the upside could be another sign that the Eurozone and the US are recovering.

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*“Monthly data since May have kept hopes for a v-shaped recovery alive”*

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Looking ahead, monthly data since May have kept hopes for a v-shaped recovery alive. Or let's better call this a v-shaped rebound.

Whether it is the traditional macro indicators or the more experimental data, they have all surged until July. It is now up to the hard data to follow suit. It will take until the hard July data before we really know whether the initial and more mechanical rebound after lifted lockdown measures, will turn into a strong and sustainable recovery or rather a quick flattening out.

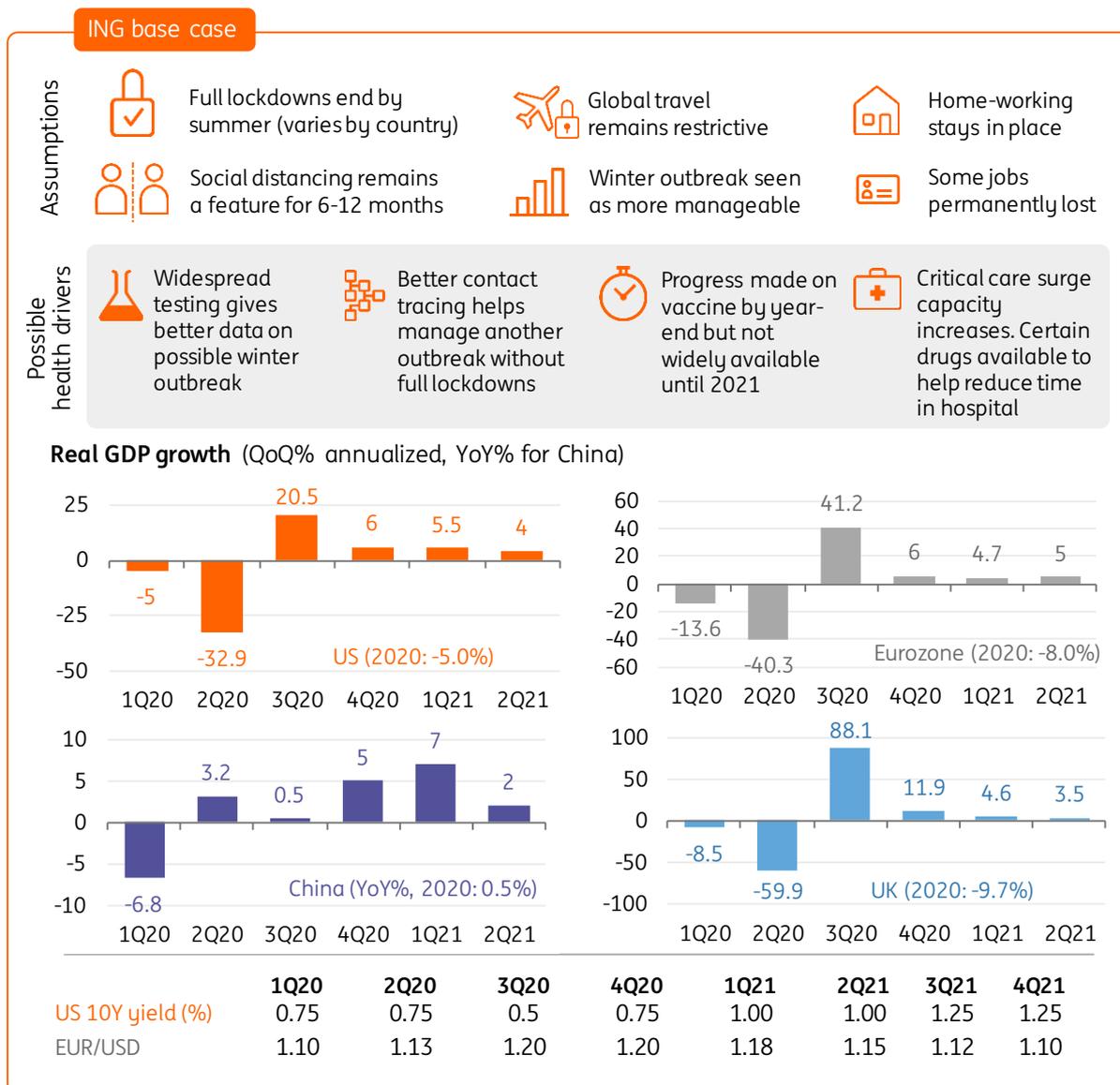
Several factors will determine the shape of the recovery in the second half of the year. The experiences of many Asian countries and first European countries show that new outbreaks of the virus cannot be prevented. The only question is whether authorities can withstand local curfews rather than larger-scale lockdowns. Also, the permanent damage of the crisis is still hard to gauge but it is hard to believe that sectors like retail, leisure or tourism have already seen the full and final impact from the crisis on employment. 'High uncertainty' will be the key phrase for all forecasters and policymakers. It will take until September before the global economy will get new guidance from macro data, policymakers and politics.

With regards to politics, now that European leaders have shown solidarity and agreed on a historic deal (which will have stronger symbolic than economic impact), financial markets' focus will probably shift to the US presidential elections. Given the experiences of the last few years, the election campaign alone has the potential of sending some shock waves to the global economy.

Looks as if all of us better tank up some energy to prepare for an action-loaded fall season. Happy staycation.

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## ING's three scenarios for the global economy and markets



### Alternative scenarios

#### Scenario 2: Winter lockdowns return

- Lockdowns end by summer but come back over winter
- Winter outbreak not manageable
- Social distancing remains a feature for 12 months

2020 GDP	United States	Eurozone	China	Markets (End 2020)	10Y yield	EUR/USD
	-6.4%	-10.0%	-2.7%		0.25%	1.10

#### Scenario 3: 'Worst case'

- Social distancing rules tightened for prolonged period of time
- Vaccine unavailable to the masses for 12-18 months
- Stricter social distancing remains a feature for 12-18 months

2020 GDP	United States	Eurozone	China	Markets (End 2020)	10Y yield	EUR/USD
	-7.9%	-12.7%	-4.5%		0.00%	1.05

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## US: Forget the “V”

**With virus fears on the rise, jobs being lost and incomes squeezed, we feel the second phase of the recovery will be much more challenging, especially in the absence of a new broad and substantial fiscal package. And all of this suggests, financial markets optimism on a 'v' -shaped rebound could be severely tested in the next couple of months**



Movement of people wearing a protective mask and maintaining social distance, Domino Park, Brooklyn.  
Source: Shutterstock

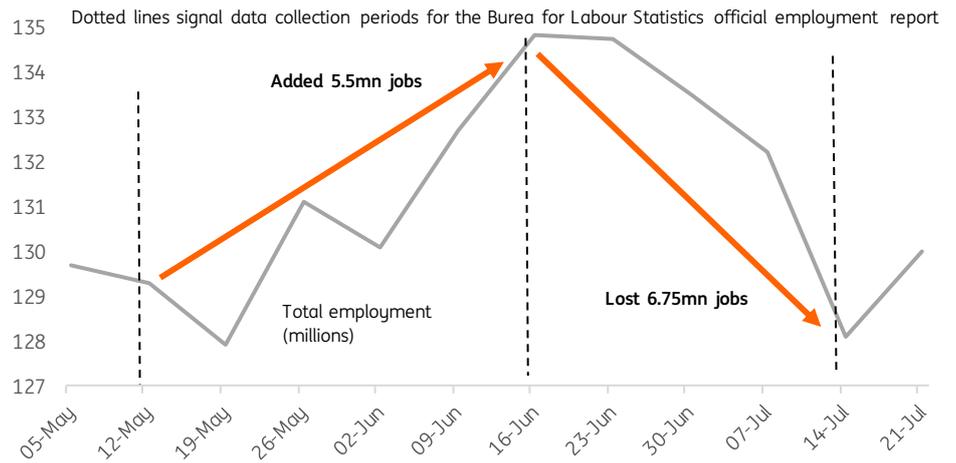
US economic output plunged 10.6% through the first half of the year. Yet as containment measures were eased through May and June the economy has bounced back strongly, led by the US consumer. There was certainly plenty of pent-up demand as we escaped the confines of our homes, but substantial stimulus from both the Federal Reserve and the Federal government undoubtedly fueled the recovery story.

Aggressive central bank action lowered borrowing costs, kept credit flowing and supported confidence and asset prices. Meanwhile, a \$2+ trillion fiscal package provided a critical lifeline to households and businesses. Unfortunately, there are growing challenges to the recovery story.

Firstly, the recent spike in Covid-19 cases is hurting confidence. It is also leading many State Governors to reverse course on their re-opening plans as they worry about strains on their healthcare systems if rising infection rates are left unchecked. The result is that businesses that had re-opened are being forced to close again with workers losing their jobs.

The Census Bureau's new Household Pulse survey suggests that employment may have reversed much of its gains since May. Perhaps most critically for near-term consumer spending the US\$600/week unemployment benefit boost given to 30 million claimants ended in July. Talks on another fiscal stimulus are dragging but in all likelihood, it might be replaced with something much smaller in size.

### Census Bureau Household pulse - employment millions



So, with virus fears on the rise, jobs being lost and incomes squeezed, the second phase of the recovery will be more challenging. In the absence of a timely and substantial fiscal package we should be braced for the threat of weaker employment and spending numbers, which will provide a major test for financial market optimism on the “V” shaped recovery.

# Eurozone: Better, but the fear factor remains

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**After the historic GDP contraction in 2Q, Eurozone economic figures have improved, though the flare-up of Covid-19 infections has placed a burden on the recovery**



A view of a deserted beach in Benidorm, Spain, one of Spain's hotspots for tourism. Source: Shutterstock

## Historic GDP contraction

So we now have official figures that we can in the future refer to as the worst in history.

In the second quarter of 2020, Eurozone GDP contracted by 12.1%, with Spain even printing an 18.5% contraction. The good news is that as lockdown measures are eased, the European Commission's economic sentiment indicator has now risen three months in a row, with July's 87 point level firmly above the second quarter's average of 71.1.

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*“We maintain our -8.0% GDP forecast for this year, while slightly lifting our 2021 outlook to 4.8%”*

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While for 3Q the V-shaped recovery is still in place, the flaring up of Covid-19 infections clearly signals that until an effective vaccine is available, life will not return to normal.

The disappointing Spanish tourism season shows how vulnerable a great number of service sectors remain to the pandemic's vagaries. The health risk and targeted confinement measures are keeping consumers hesitant, leading to a higher propensity to save. On the plus side, the European Union has now decided on a recovery fund, which will provide about 0.8% of GDP fiscal stimulus, both in 2021 and 2022. We maintain our -8.0% GDP forecast for this year, while slightly lifting our 2021 outlook to 4.8%.

## Inflation quirk

Notwithstanding the VAT rate cut in Germany, Eurozone core inflation actually increased from 0.8% to 1.2% in July.

However, this is probably a statistical quirk, since the sales period has been delayed until August in a number of countries, rendering the year-on-year comparison less favourable in July. That said, 2021 could see somewhat higher inflation as the German VAT rate will increase again and energy price inflation becomes positive.

But even then, we are only pencilling in 1.4% headline inflation.

### **Euro trouble**

Meanwhile, the euro's effective exchange rate has gained around 6% since February and it is not that far away from an all-time high.

While it might be too soon for the European central bank to counteract, it is definitely a factor that will contribute to low inflation, soliciting dovish comments from the ECB. And even if the tightening of spreads on sovereign bond yields could incite the central bank to slow down its bond purchases, the stronger common currency leads us to believe that an additional €400bn of PEPP remains feasible.

# China's tech war with the US has made us revise our yuan forecast

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**The persistence of the technology war is hurting long term Chinese growth and the yuan's strength. Although we're revising our yuan forecast, it isn't much stronger from the current spot**



In this photo illustration, a TikTok logo is seen displayed on a smartphone with the Chinese and American flag in the background. Source: Shutterstock

## New challenges to economic growth

The Chinese economy is recovering. GDP grew by 3.2% year-on-year in 2Q20 but there are new challenges ahead.

- The first-in-first-out from Covid-19 has been China's advantage compared to other economies. There have been some small clusters recently, but the government has acted swiftly to impose very tight social distancing measures, limiting the impact on the economy.
- There has been widespread flooding affecting agriculture as well as infrastructure construction. The typhoon season has also arrived, bringing more uncertainty to the flood damage.

These two challenges hurt short-term economic growth, and the government has offered help to offset some of the damage, so we are not too worried that these will hit GDP growth significantly in 2H20.

The longer-term challenge to the economy is the US becoming increasingly aggressive towards Chinese tech companies. US companies are banned from doing business with more Chinese companies and there were renewed threats on Huawei in May. Recently, the US administration has forced TikTok, whose parent company is a Chinese corporate, to be sold to US companies or stop operating in the US.

This hurts China's long term growth in technology exports.

## The yuan strengthens but only slightly

This technology war has put yuan strength at risk.

Even though China has fought against Covid-19 quite successfully, the yuan depreciated against the dollar to 7.1680 per dollar in May, which was the peak in 2020, as a result of the renewed threats to Chinese telecommunications group Huawei.

But in June, economic indicators improved and since then the Chinese economy has started to recover. From its peak, USD/CNY at 7.1680 to 6.9809 on 3 August, the yuan has appreciated by 2.61%.

If we measure the yuan's performance from the beginning of 2020, then it is still 0.25% weaker against the USD. This is in contrast with the dollar index's 2.95% depreciation over the same period. Some of the yuan appreciation that should have reflected in the USD/CNY exchange rate has been offset by the technology war.

We expect the technology war to persist for the rest of the year, which will continue to affect the yuan's performance.

We have revised our USD/CNY forecast to 6.97 from the previous 7.05 by the end of 2020.

We expect a stronger yuan from the previous forecast but the strength of the yuan from now to the end of 2020 is likely to be hit by negative news from the tech war.

# FX: King dollar loses its crown

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The dollar's four percent decline in July marked its largest monthly drop since 2010. Driving this decline is both a re-rating of the European project, but also the dollar's loss of its growth and yield advantage. The latter leaves the dollar vulnerable into November's contentious presidential elections



Source: Shutterstock

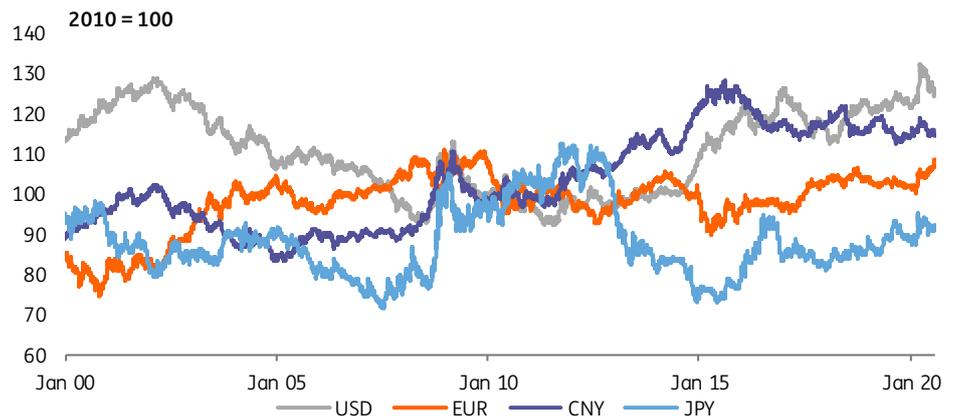
## Dollar: We don't need you any more

The myriad of factors which propelled the dollar around eighteen percent higher between March 2018 and March 2020 have faded. The dollar rally in 2018 and 2019 was all about large US fiscal stimulus and then US protectionism. These drove a growth and interest rate wedge between the US and the beleaguered overseas economies.

The dollar rally in March 2020 was all about liquidity needs. The fact that foreign central banks are now only drawing down around US\$100bn from the Fed's dollar swap lines – versus a peak of US\$450bn in May – suggests the need for emergency dollar liquidity or hoarding has reversed.

In other words, dollar demand from both the investor and commercial community is in decline and the dollar is no longer the only game in town.

## Trade weighted exchange rate indices: USD retreats from highs



Source: BIS

### **Euro: A reluctant alternative**

Progress on the EU recovery fund has prompted a re-assessment of the European project and the euro. Investor surveys show the fund management community are still overweight US equities but inclined to move into Europe. Depending on the path and handling of Covid-19 second wave, a re-allocation of funds towards Europe should be the theme for 2H20.

We expect EUR/USD to maintain its bullish momentum into an uncertain US presidential election in November. That means pressing 1.20, with outside risk to 1.25. This environment should also favour the liquid, defensive currencies of JPY and CHF – as the market seeks dollar alternatives.

**ING global forecasts**

	2020					2021					2022
	1Q20	2Q20	3Q20	4Q20	FY	1Q21	2Q21	3Q21	4Q21	FY	FY
<b>United States</b>											
GDP (% QoQ, ann)	-5	-32.9	20.5	6	-5	5.5	4	3.5	3	3.6	3.1
CPI headline (% YoY)	2.1	0.4	1.1	1.1	1.2	1.4	2.9	2.3	2.3	2.2	2.1
Federal funds (% eop)	0.25	0.25	0.25	0.25		0.25	0.25	0.25	0.25		0.5
3-month interest rate (% eop)	0.5	0.3	0.3	0.3		0.3	0.3	0.3	0.3		0.7
10-year interest rate (% eop)	0.75	0.65	0.5	0.75		1	1	1.25	1.25		1.75
Fiscal balance (% of GDP)					-20.4					-10.1	-5.7
Gross public debt / GDP					103.2					107.5	107.8
<b>Eurozone</b>											
GDP (% QoQ, ann)	-13.6	-40.3	41.2	6.1	-8	4.7	5	3	2.1	4.8	2.5
CPI headline (% YoY)	1.1	0.2	0.3	0.2	0.5	1.1	1.4	1.5	1.4	1.4	1.4
Refi minimum bid rate (% eop)	0	0	0	0		0	0	0	0		0
3-month interest rate (% eop)	-0.4	-0.45	-0.45	-0.45		-0.45	-0.45	-0.45	-0.4		-0.4
10-year interest rate (% eop)	-0.47	-0.45	-0.4	-0.3		-0.25	-0.2	-0.2	-0.2		0
Fiscal balance (% of GDP)					-9.6					-4.6	-2.7
Gross public debt/GDP					105.9					104	101.2
<b>Japan</b>											
GDP (% QoQ, ann)	-2.0	-25.0	18.0	2.0	-4.9	0.5	1.0	1.0	1.0	1.0	1.1
CPI headline (% YoY)	0.5	0.1	0.3	0.1	0.3	0.4	0.8	0.9	0.7	0.7	0.7
Interest Rate on Excess Reserves (%)	-0.1	-0.1	-0.1	-0.1		-0.1	-0.1	-0.1	-0.1		-0.1
3-month interest rate (% eop)	0.00	0.00	0.00	0.00		0.00	0.00	0.00	0.00		0.00
10-year interest rate (% eop)	0.00	0.00	0.00	0.00		0.00	0.00	0.00	0.00		0.00
Fiscal balance (% of GDP)					-16.9					-9.8	-8.9
Gross public debt/GDP					222					228	232
<b>China</b>											
GDP (% YoY)	-6.8	3.2	0.5	5	0.5	7	2	6	4.5	5.4	4.1
CPI headline (% YoY)	5	2.6	2.2	1.9	2.9	2	2.5	2.5	2.9	2.5	2.5
PBOC 7-day reverse repo rate (% eop)	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
3M SHIBOR (% eop)	1.9	2	2.8	3	3	3	3.1	3.2	3.3	3.3	3.7
10-year T-bond yield (% eop)	2.6	2.9	3	3.3	3.3	3.4	3.5	3.6	3.7	3.7	4
Fiscal balance (% of GDP)					-8					-5	-4
Public debt (% of GDP), incl. local govt.					112					115	118
<b>UK</b>											
GDP (% QoQ, ann)	-8.5	-59.9	88.1	11.9	-9.7	4.6	3.5	2.5	1.3	6.3	1.8
CPI headline (% YoY)	1.7	0.6	0.6	1.0	1.0	1.1	1.9	1.8	1.8	1.7	1.7
BoE official bank rate (% eop)	0.1	0.1	0.1	0.1		0.1	0.1	0.1	0.1		0.25
3-month interest rate (% eop)	0.6	0.2	0.2	0.2		0.2	0.2	0.25	0.3		0.4
10-year interest rate (% eop)	0.3	0.2	0.3	0.3		0.4	0.5	0.6	0.7		1.2
Fiscal balance (% of GDP)					-15.5					-6.9	-3.5
Gross public debt/GDP					112					110.5	110.5
EUR/USD (eop)	1.10	1.13	1.20	1.20		1.18	1.15	1.12	1.10		1.10
USD/JPY (eop)	107	107	103	102		102	105	108	110		110
USD/CNY (eop)	7.08	7.07	7.00	6.97	6.97	6.93	6.87	6.83	6.8	6.8	6.7
EUR/GBP (eop)	0.89	0.91	0.92	0.9		0.90	0.88	0.88	0.88		0.85
Brent Crude (\$/bbl, avg)	51	33	40	50	43	50	60	60	63	58	65

GDP forecasts are rounded to the nearest whole/half number, given the large magnitude and uncertainty surrounding our estimates

Source: ING forecasts

**Real GDP growth (QoQ% annualised unless otherwise state) and market forecasts**

<b>Scenario 1 - Base case</b>											
	2020					2021					2022
	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY	
United States	-5	-32.9	20.5	6	-5.0	5.5	4	3.5	3	3.6	3.1
Eurozone	-13.6	-40.3	41.2	6	-8.0	4.7	5	3	2.1	4.8	2.5
China (YoY%)	-6.8	3.2	0.5	5	0.5	7	2	6	4.5	5.4	4.1
Japan (QoQ%)	-2.2	-25	18	2	-4.9	0.5	0.9	0.9	0.9	1	1.1
United Kingdom	-8.5	-60	90	12	-9.7	4.6	3.5	2.5	1.3	6.3	1.8
EUR/USD	1.1	1.13	1.20	1.20		1.18	1.15	1.12	1.10		1.10
USD/JPY	107	107	103	102		102	105	108	110		110
US 10-year yield (%)	0.75	0.75	0.5	0.75		1.00	1.00	1.25	1.25		1.75
<b>Scenario 2 – Winter lockdowns return</b>											
	2020					2021					2022
	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY	
United States	-5	-32.9	19.5	-15	-6.4	4	12	9	5	1	5
Eurozone	-13.6	-40.3	41.2	-25	-10	20	10	3	2.1	2.4	2.8
China (YoY%)	-6.8	3.2	-2	1	-2.7	4	3	2	2	2.8	3.3
Japan (QoQ%)	-2	-25.5	19	-11	-5.6	-1	0	0	0	-2	0
United Kingdom	-7.7	-60.0	90.0	-30.0	-12.1	4.0	22.0	7.0	5.0	1.2	4.1
EUR/USD	1.1	1.13	1.15	1.10		1.15	1.20	1.15	1.10		1.10
USD/JPY	107	107	100	100		100	103	105	105		105
US 10-year yield (%)	0.75	0.75	0.50	0.25		0.75	0.75	0.75	1.00		1.50
<b>Scenario 3 – 'Worst case'</b>											
	2020					2021					2022
	1Q20	2Q20	3Q20	4Q20	FY	1Q21	2Q21	3Q21	4Q21	FY	
United States	-5	-32.9	10	-23	-7.9	2	4	5.5	11	-3.3	8.2
Eurozone	-13.6	-40.3	5	-18	-12.7	2	4	3.5	20	-3.6	5.6
China (YoY%)	-6.8	3.2	-4	-2	-4.5	0	3	3.5	4	2.6	3
Japan (QoQ%)	-2	-25	19	-9.5	-5.5	-4	-4.5	-4.5	-4	-4.1	-2
United Kingdom	-7.7	-62	-6.1	3.1	-18	1.8	5.7	10	20	-2.7	12.5
EUR/USD	1.1	1.13	1.10	1.05		1.15	1.30	1.20	1.20		1.20
USD/JPY	107	107	100	90		95	100	100	100		100
US 10-year yield (%)	-0.75	0.75	0.25	0.00		0.25	0.25	0.25	0.50		1.00

Source: ING (Note most growth forecasts rounded to nearest whole or half number)

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