

# LIVING ON WITH A COVID19 HUM

Allianz Research

**Global Economic Outlook**  
*September 2020*



# WHAT CHANGED, WHAT'S NEXT (1/2)

	What was in line with expectations	What surprised	What to expect next (2021 and beyond)
<b>Covid-19 sanitary restrictions</b>	Renewed infection waves requiring tighter sanitary restrictions and targeted lockdowns.	Slow rise in cases in intensive care which could suggest that future waves could be more contained.	Stop-and-go approach from governments. Vaccine available in Sept 2021, but 6 months needed for campaign. Return to normal in 2022.
<b>Economic activity</b>	Less open economies, less reliant on services and benefitting from short-term demand stimulus packages have registered stronger acceleration	Stronger than expected catch-up effects for retail sales, residential market and exports of goods.	Divergence in pace of recovery due to (i) structure (manufacturing economies likely to benefit more the recovery); (ii) composition of stimulus packages (demand/supply) + speed of disbursements; (iii) confidence effects.
<b>Global confidence and political risk</b>	Low consumer confidence amid rising concerns on unemployment and financial, keeping excess savings at a high level.	Rapidly improving business confidence in contrast with still weak fundamentals. Political uncertainty increased in UK as probability of Hard Brexit now 45%.	Busy political calendar (US elections and Brexit outcome in 2020, Germany and the Netherlands in 2021, France in 2022) will shape future fiscal stimuli. Expectations: last minute (partial) agreement on Brexit. Joe Biden victory. More redistributive policies towards households.
<b>Investment cycle</b>	No acceleration in investment in the manufacturing sector as long as: (i) the sanitary crisis is not (close) to be solved and (ii) uncertainty on demand remains high.	Confidence in the manufacturing sector improved strongly during summer on the back of above-expectations catch-up effects. Recovery in residential investment was stronger than expected.	K shape recovery in investment to prevail. Investments, notably in the manufacturing sector, to accelerate more visibly in H2 2021 as confidence effects improve and stimulus packages materialize.
<b>Global Trade, protectionism, globalization</b>	Services lagging behind goods in recovery. US-China trade tensions contained, but cold "tech" war to continue.	Stronger than expected recovery in goods trade during the summer (currently 3% below last August)	No full de-globalization: some reshoring but mostly diversification (multi-shoring). Goods back to pre-crisis level in 2022, services in 2023.

# WHAT CHANGED, WHAT'S NEXT (2/2)

	What was in line with expectations	What surprised	What to expect next (2021 and beyond)
<b>Global prices</b>	Disinflationary pressures confirmed due to temp. factors (tax cuts, delayed summer sales), negative output gaps + falling money velocity.	Record high levels in gold price during summer suggest increased worries about stagflation. Markets are actually ambivalent about the long-term inflation outlook (fixed income pricing stagflation).	+0.3% inflation in 2020 in EZ and +1.1% in the US; progressive reflation in 2021 (+0.9% and +1.6% respectively). Expect >2% US inflation from 2022. Higher inflationary pressures in EM starting end-2021. Oil prices up at 51 bbl/USD 2021.
<b>Monetary policy</b>	Global liquidity reached record high levels during summer, but transmission is not efficient given the lack of confidence of the private sector	Fed introduced new monetary policy target=> comfortable with temporary inflation overshoot; no normalization before unemployment reaches 4 to 5%	Fed QE tapering in late 2022. No rate hike by Fed before Q3 2023. ECB is likely to announce EUR500bn in QE in Dec. 2020. BoE likely to increase QE size by GBP100bn in 2021.
<b>Fiscal policy</b>	Large phase II fiscal stimulus packages have been announced, notably in Europe, along with the reduction in relief measures	Some countries continued to lag in terms of size of stimulus (Spain, Italy, UK). Higher risks of a fiscal cliff in the US.	Size + spending calendar of stimulus matter for countries. Focusing on supply = more time before reaching pre-crisis levels. Fiscal consolidation efforts will start in EM in 2022 as debt sustainability worries increase.
<b>Currencies and capital flows to EM</b>	Depreciations in EM currencies eased during summer. Negative real rates continues to support risk appetite. Weaker EM (TRY, ZAF) still on watchlist.	Stronger than expected EUR	Moderate depreciation of the USD: -2.5% in 2021 (1.22) followed by an appreciation +3% end-2022 (1.18). As long as USD depreciates, positive capital flows in the EM.
<b>Financial markets</b>	It can still get worse before it gets better.	Technology sector driven equity market correction due to extreme options market positioning.	Equity and Corp. markets set to remain under pressure due to extreme valuations. Gvt bond markets to remain anchored at low levels.

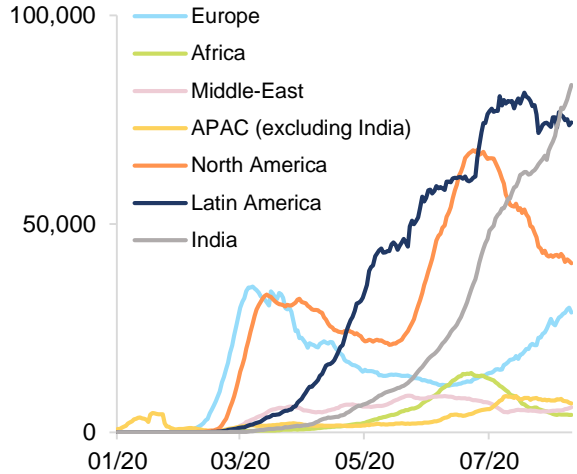
**GLOBAL OUTLOOK: LIVING  
WITH UNCERTAINTY**

**01**



# COVID-19: LIVING WITH THE VIRUS AND 194 STOP-AND-GO STRATEGIES

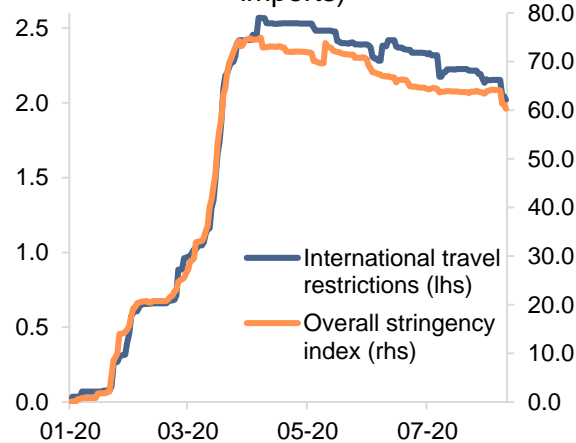
Daily number of new Covid-19 cases



Sources: John Hopkins University, Allianz Research

Waves of reinfections to be increasingly more visible in countries which relaxed sanitary restrictions: after Europe, Africa + Latin America should follow. APAC to remain under control.

Global stringency indices  
(weighted by GDP and travel services imports)



Sources: Oxford University, Allianz Research

Reinfections will push for a stop-and-go strategy. International travel to remain restricted until 2022 when we expect the end of the sanitary crisis

Stringency index

100 = maximum stringency/lockdowns, 0 = no distancing

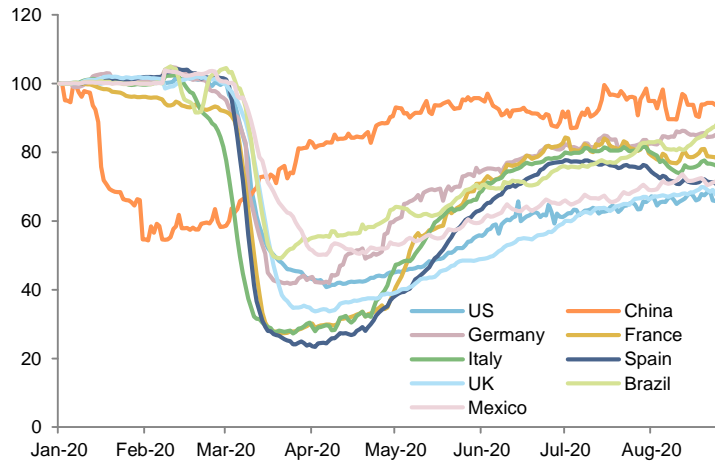
- Starting from Q3 2020 and until Q4 2021, no sanitary “normalization” but a stop-and-go strategy on distancing measures, alternating between
  - Targeted lockdowns (Spain, Israel) or more stringent distancing measures (UK, France, US...) every time cases rise
  - Relaxed measures every time cases are controlled again

*Hiccups in economic activity due to alternation of higher and lower stringencies of sanitary restrictions*

- Stringency indices to end 2021 between 10 and 20 in most countries, levels similar to the start of the sanitary crisis
- Return to ~0 stringency by end of Q1 2022 after a 6-months vaccination campaign starting in Q4 2021

# COVID-19 TWILIGHT ZONE: DIVERGING WHILE PLATEAURING

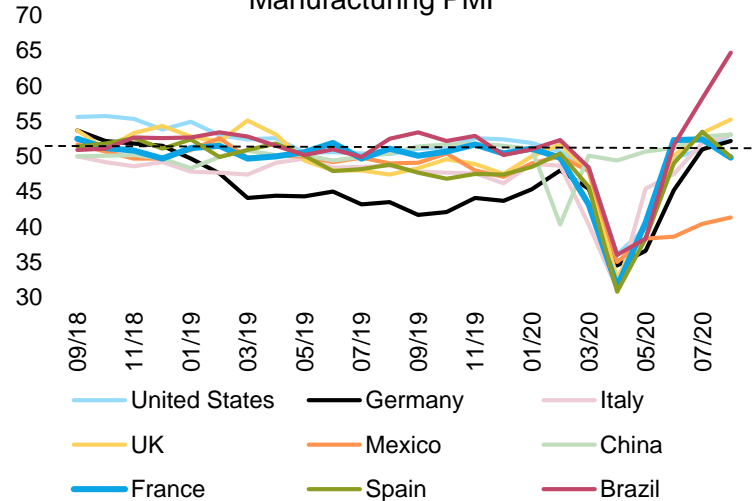
Daily activity index (mobility, jobs and retail)



Sources: Bloomberg, Allianz Research

We see the recovery in daily activity rates plateauing in most countries and even changing course in Spain, in line with stringency indices stabilizing and new outbreaks

Manufacturing PMI

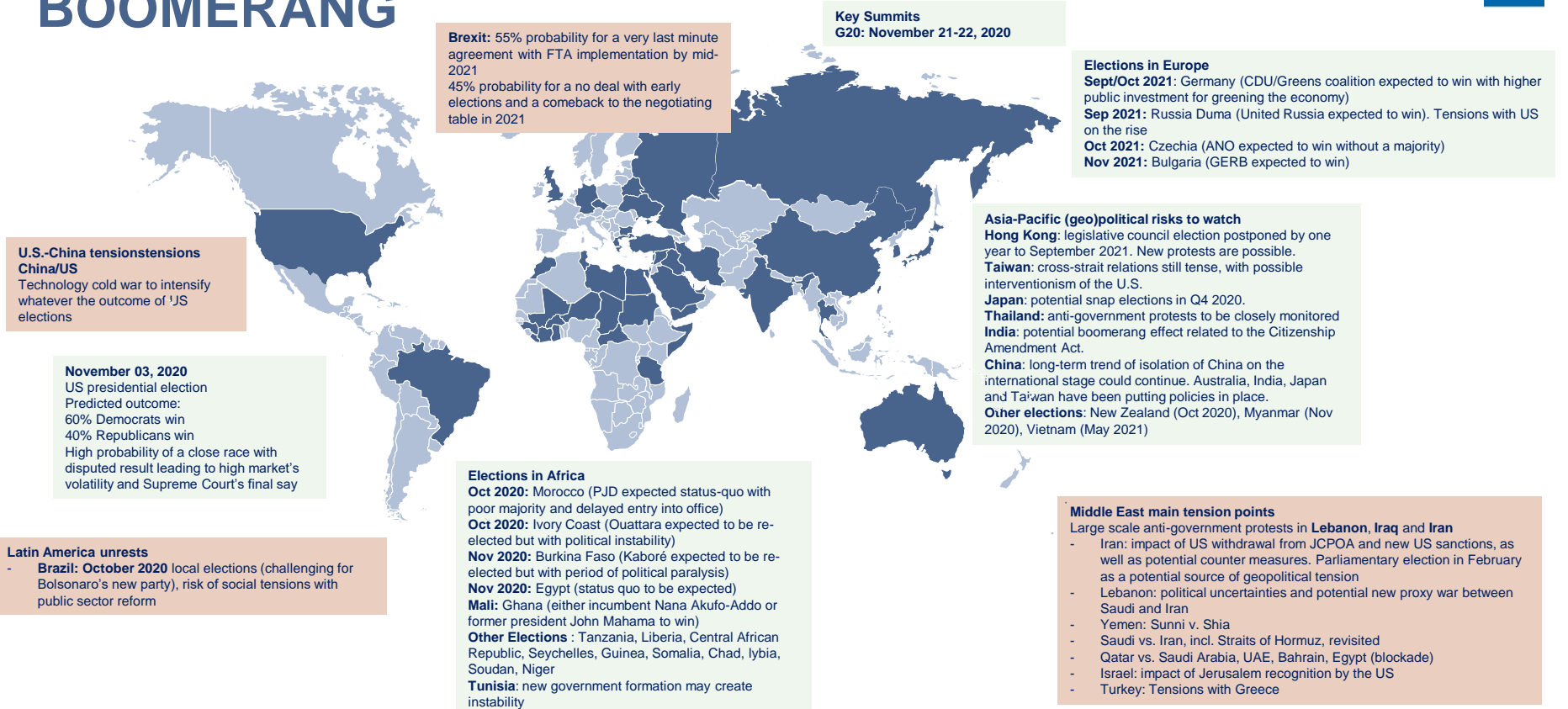


Sources: Markit, Allianz Research

Activity expectations in the manufacturing sector are likely to plateau at current levels post-summer catch-up effects. In countries where sanitary restrictions tightened (Spain, France), the index is back in contractionary territory

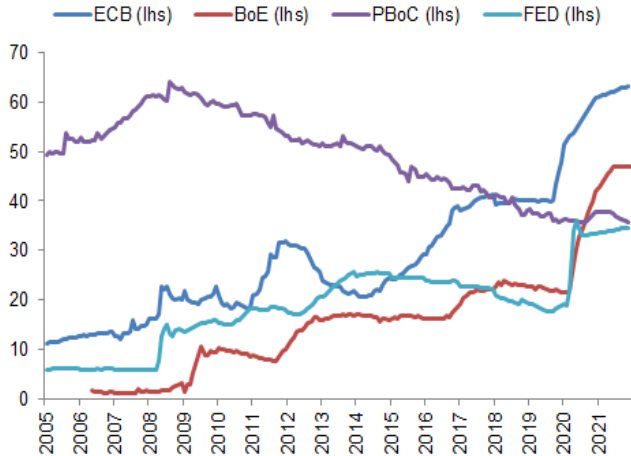


# COVID19+: POLITICAL RISK IS BACK LIKE A BOOMERANG



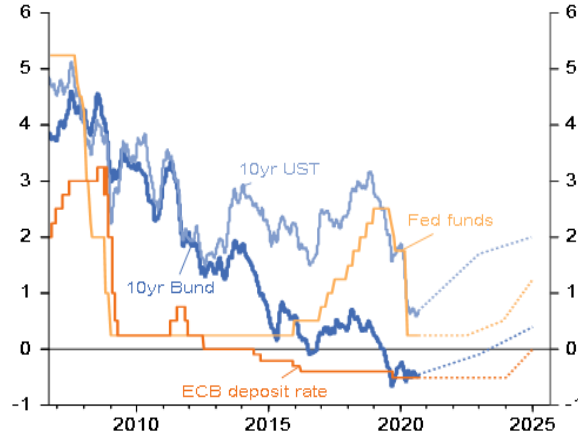
# MONETARY POLICY: LOWER-FOR-MUCH-LONGER, WATCH CURRENCY CONSEQUENCES

Central Banks Balance Sheets (% of GDP)



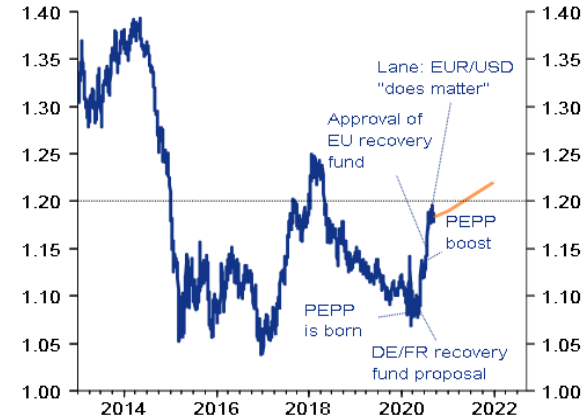
Sources: national sources, Allianz Research

Key interest rates vs 10-year yields



Sources: national sources, Allianz Research

EUR to USD



Sources: Refinitiv, Allianz Research

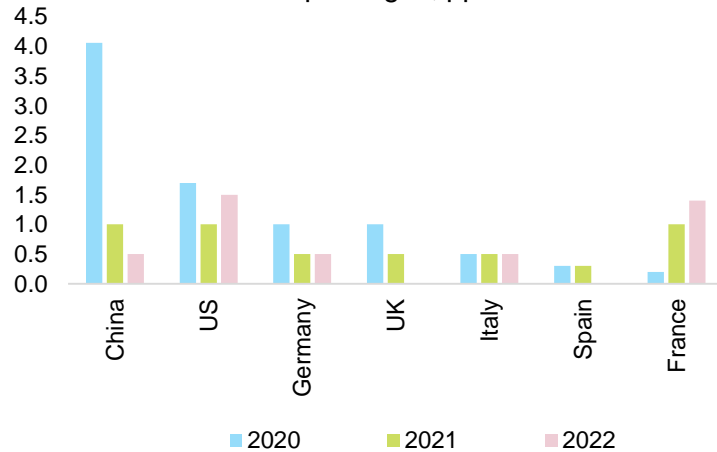
Global liquidity is at a record high level and should continue to increase. The ECB is expected to announce EUR500bn additional QE purchases in December. The Fed is likely to continue to expand its balance sheet to USD7.7tn end of 2021, before a progressive tapering starting in H2 2022.

We expect a start of tightening in monetary and financial conditions in 2022, as markets anticipate the Fed will hike interest rates in H2 2023. We expect the USD to depreciate by -2.5% in 2021 (to 1.22) followed by an appreciation of +3.0% in 2022 (1.18)



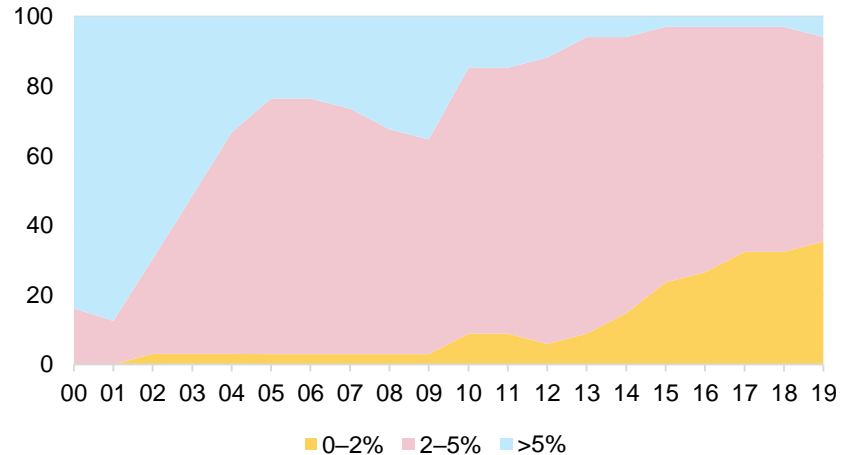
# FISCAL POLICY: MORE THAN A QUICK FIX BUT BEWARE OF EXECUTION RISKS

Expected impact on GDP growth from fiscal stimulus packages, pp



Sources: national sources, Allianz Research

Distribution of average interest paid on debt (% of total countries, advanced economies)

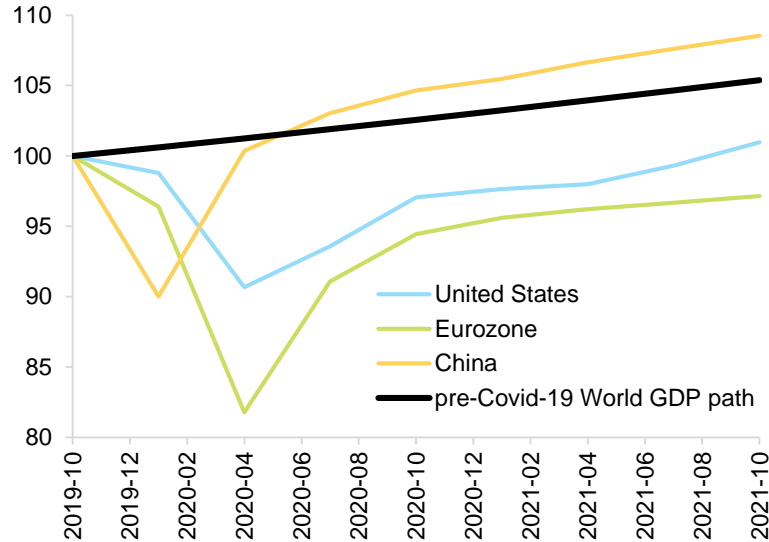


Sources: national sources, Allianz Research

Spending paths matter even more than size: supply side stimulus packages (e.g. France) will need more time to see positive impact on growth (vs. Germany, UK which focused on short-term measures). China will focus on avoiding excessive private debt while the US should push public debt into new highs post elections. Fiscal status quo in Germany post 2021 elections. Risks to the implementation of the EU Recovery Fund by mid-2021 remain high. Debt sustainability insured by prolonged accommodative monetary policies and longer average-time to maturities.

# FORECASTS: THE LAST MILE IS THE HARDEST

Real GDP, Q4 2019 = 100



Sources: national sources, Allianz Research

China should continue to lead the way in the recovery while the US should reach its pre-crisis GDP levels end-2021. Europe will remain the laggard until 2022 even if divergence prevails (Germany and the Netherlands recover faster than Spain, Italy, UK)

Real GDP growth forecasts, %

	2017	2018	2019	2020	2021
<b>World GDP growth</b>	<b>3.3</b>	<b>3.1</b>	<b>2.5</b>	<b>-4.7</b>	<b>4.6</b>
United States	2.4	2.9	2.3	-5.3	3.7
<b>Latin America</b>	<b>1.0</b>	<b>1.0</b>	<b>0.1</b>	<b>-7.9</b>	<b>3.3</b>
Brazil	1.3	1.3	1.1	-6.5	2.5
United Kingdom	1.8	1.3	1.5	-11.8	2.5
<b>Eurozone members</b>	<b>2.7</b>	<b>1.9</b>	<b>1.3</b>	<b>-7.9</b>	<b>4.8</b>
Germany	2.8	1.5	0.6	-6.0	3.5
France	2.4	1.8	1.5	-9.8	6.9
Italy	1.7	0.7	0.3	-10.1	4.2
Spain	2.9	2.4	2.0	-11.8	6.4
Russia	1.8	2.5	1.3	-5.1	2.9
Turkey	7.5	3.0	0.9	-4.7	4.0
<b>Asia-Pacific</b>	<b>5.2</b>	<b>4.7</b>	<b>4.2</b>	<b>-1.5</b>	<b>6.2</b>
China	6.9	6.7	6.1	2.0	8.4
Japan	2.2	0.3	0.7	-5.5	2.5
India	7.0	6.1	4.2	-7.2	6.5
<b>Middle East</b>	<b>1.4</b>	<b>0.9</b>	<b>0.3</b>	<b>-7.1</b>	<b>2.3</b>
Saudi Arabia	-0.7	2.4	0.3	-5.1	2.0
<b>Africa</b>	<b>3.1</b>	<b>2.7</b>	<b>1.9</b>	<b>-4.3</b>	<b>3.4</b>
South Africa	1.4	0.8	0.3	-8.2	2.7

\* Weights in global GDP at market price, 2019

NB: fiscal year for India

Sources: national sources, Allianz Research

# FISCAL IMPULSE: FOR CONSUMERS OR VOTERS?



Policy interventions to protect household purchasing power (in red countries with elections in 2020-21)

	AUS	BEL	DEU	PER	CHL	ISR	FRA	GBR	ITA
Expansionary monetary policy	✓	✓	✓	✓	✓	✓	✓	✓	✓
Temporary debt relief		✓	✓	✓	✓	✓			✓
Targeted interventions	✓		✓	✓	✓		✓	✓	✓
Expansion of existing programmes			✓				✓	✓	✓
Wage subsidies	✓	✓	✓	✓	✓	✓	✓	✓	✓
Temporary tax relief		✓	✓	✓	✓	✓		✓	

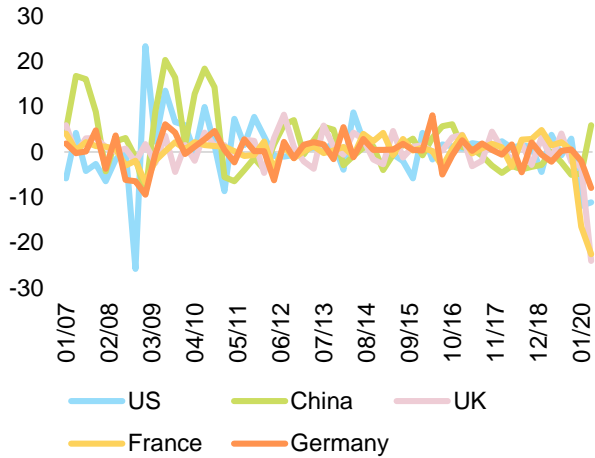
  

	BRA	IND	PHI	SWE	HUN	JPN	S-KR	NTL	USA
Expansionary monetary policy	✓	✓	✓	✓	✓	✓	✓	✓	✓
Temporary debt relief	✓	✓	✓	✓	✓				✓
Targeted interventions	✓					✓	✓		
Expansion of existing programmes			✓				✓	✓	✓
Wage subsidies		✓		✓	✓		✓	✓	
Temporary tax relief	✓	✓		✓	✓	✓		✓	✓

Sources BIS, IMF Policy Tracker, Allianz Research

# INVESTMENT: WITHOUT CONFIDENCE, CASH AND DEBT MAY PILE UP - FOR NOTHING

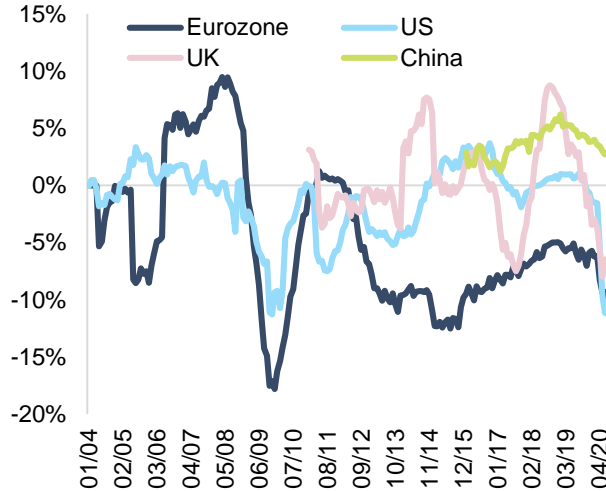
Non-financial corporations' gross operating surplus, q/q\*



Sources: Macrobond, Allianz Research; \*for China: industrial profits

The Covid-19 profitability shock will weigh on companies' investment future intentions, notably as a majority of State support schemes arrive at maturity end of 2020

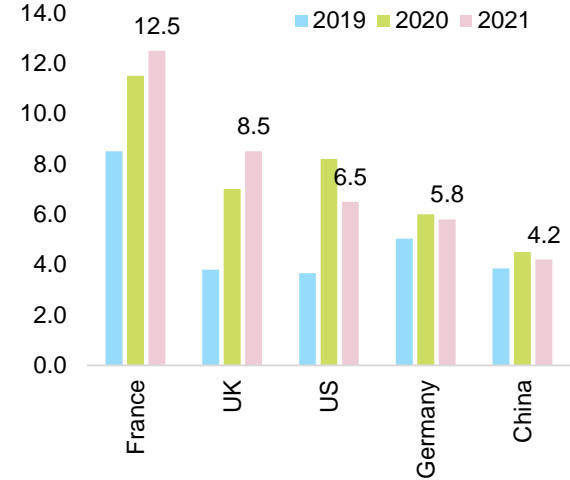
Credits (y/y) – Deposits (y/y)



Sources: Macrobond, Allianz Research

Cash hoarding from the private sector is a sign of lack of confidence and suggests a difficult start for a new investment cycle

Unemployment rate, %



Sources: Markit, Caixin, Allianz Research

Deteriorating labor markets will continue to weigh on consumers confidence and keep precautionary savings high

# INSOLVENCIES: +31% BY END-2021 AS TEMPORARY SUPPORT SCHEMES END



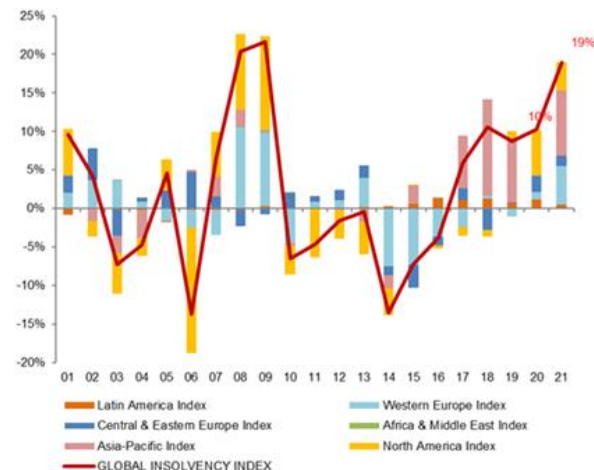
Insolvency figures and forecasts  
(selected countries)

	2020			Forecasts				
	Last point	3m y/y	Ytd y/y	2020	2021	2020 y/y	2021 y/y	2021/2019
U.S.	June	-11%	-3%	31 500	37 500	39%	19%	65%
Canada	July	-26%	-30%	2 850	3 450	4%	21%	26%
Brazil	June	-26%	-16%	3 450	3 800	20%	10%	32%
Germany	June	-9%	-6%	19 350	20 850	3%	8%	11%
France	August	-37%	-36%	46 800	62 000	-9%	32%	21%
United Kingdom	June	-31%	-20%	22 929	30 072	4%	31%	36%
Italy				11 660	14 039	6%	20%	28%
Spain	August	13%	-1%	4 600	5 600	11%	22%	35%
The Netherlands	August	-23%	-7%	4 000	5 000	5%	25%	32%
Russia	June	-25%	-4%	13 800	14 500	18%	5%	23%
Turkey	July	8%	4%	17 200	18 400	22%	7%	31%
Poland	July	32%	3%	1 100	1 210	13%	10%	24%
South Africa	July	-7%	-20%	2 280	2 450	12%	7%	20%
Morocco	June	-87%	-38%	8 861	10 456	5%	18%	24%
China	August	1%	7%	13 500	14 700	14%	9%	24%
Japan	August	1%	0%	8 600	9 400	3%	9%	12%
India	June	-75%	-25%	750	2 100	-60%	180%	11%
Australia	July	-51%	-34%	6 150	7 150	-4%	16%	12%
South Korea	August	-34%	-41%	400	470	-3%	18%	14%
<b>GLOBAL INDEX</b>						<b>10%</b>	<b>19%</b>	<b>31%</b>

Sources: Euler Hermes, Allianz Research

Our EH Global insolvency index posted a -13% y/y decline in Q2 and -7% y/y for H1. This drop in official registrations of insolvencies continued in most countries during the summer, due to (i) policy measures designed to avoid liquidity and (ii) changes in insolvency frameworks designed to give time and flexibility to companies before they resort to filing for bankruptcy.

EH Global Insolvency Index (yearly changes in %) and contribution of regional indices



Sources: Euler Hermes, Allianz Research

The ending of temporary factors will lead to a trend reversal starting end of Q3 or Q4 depending on countries and accelerating in H1 2021. Our global insolvency index would surge by +31% by end of 2021, with all regions contributing to the rise. Should the recovery switch to L-shape the rises will be +50 to +60pp higher.

# TRADE: RECOVERY FOR TRADE IN GOODS, BUT REMEMBER IT'S A SERVICE CRISIS

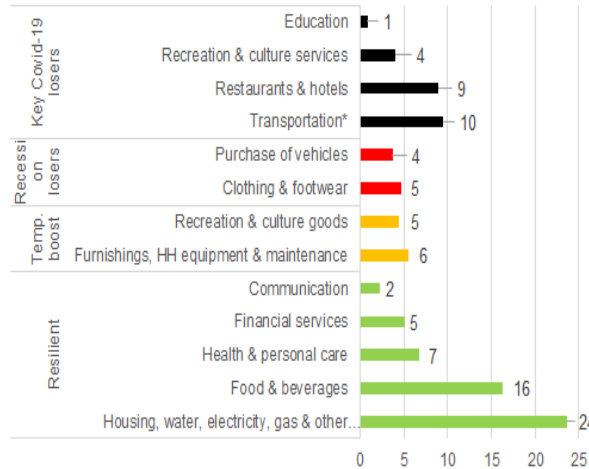
Global merchandise trade in volume (100 = Sept. 2008 and 100 = Feb. 2020)



Sources: CPB, Kiel, Allianz Research

Rebound is stronger than 2009. Yet transport & travel services will only recover in 2023 (2022 for goods): Reduced US - China uncertainty, some reshoring but no full de-globalization.

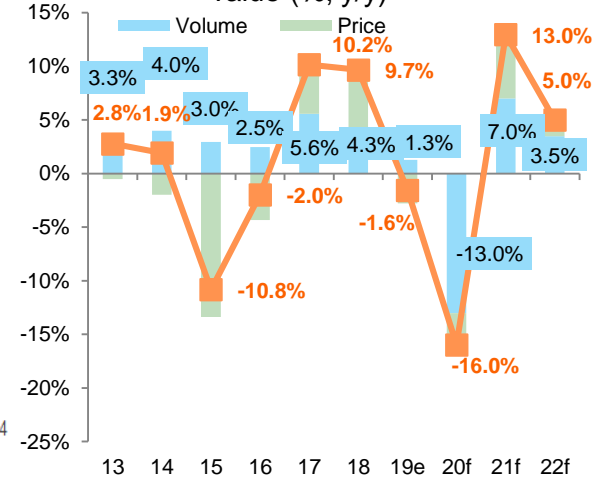
Consumption components (% total, Europe)



Sources: Refinitiv, Allianz Research

Recession victims (cyclical durables, clothing & footwear etc.) are joined by “social expenditure” (transportation, restaurants & hotels, recreation & culture services) which makes up 23% of private consumption.

Global trade growth, in volume terms and value (% , y/y)



Sources: Bloomberg, Euler Hermes, Allianz Research

Trade should contract -13% in 2020 (vs -15% previously). Oil + commodity price shock = negative price effect in 2020. 2021 = return to 51 after ~44 in 2020, + lower USD boosting value of trade.



# GLOBAL SECTORS: A MAJORITY OF SECTORS WILL COME BACK TO PRE-CRISIS LEVELS POST 2021



## NO DETERIORATION

- (Food) Retail
- Pharmaceuticals
- Agrifood (food)

## H2 2021

- Electronics
- Agrifood (farming)
- Telecoms
- Transportation (rail)
- Machinery
- Construction

## H1 2021

- IT (services)
- Agrifood (beverages)
- Chemicals

## BEYOND 2023

- (Non-food) Retail
- Transportation (air)

## 2022

- Household equipment
- Transportation (sea, road)
- Paper
- Transport equipment (ship, truck, train)
- Metals

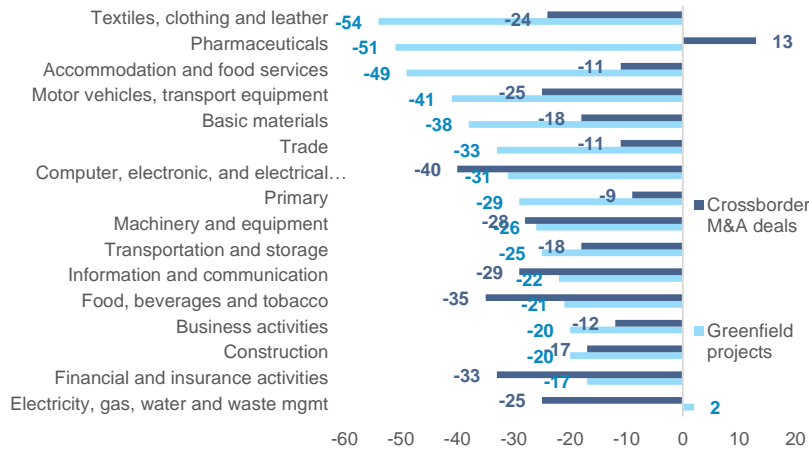
## 2023

- Textiles
- Transport equipment (aircraft)
- Automotive manufacturers
- Automotive suppliers
- Energy



# GLOBALIZATION: NOT IMMUNE TO COVID19

Number of investment projects\*/M&A, growth, monthly average, Q2 2020 vs. all 2019



Sources: UNCTAD, Allianz Research

\*With greenfield investing, a company will build its own, brand new facilities from the ground up. Different from brownfield investment happens when a company purchases or leases an existing facility

# of announced greenfield projects and cross-border M&As have seen a sharp decline. While some sectors could benefit from “reshoring”, others could win from diversification or regionalization.

Potential trajectories for international production and global trade

	RE-SHORING	DIVERSIFICATION	REGIONALIZATION	REPLICATION
<b>IMPACT ON INTERNATIONAL PRODUCTION</b>	Shorter, less fragmented value chains. Rebundling of supply chain + concentrated VA Less offshoring/outsourcing	Continued fragmentation of supply chains. Increased platform-based supply chain governance + concentrated VA Increased offshoring and outsourcing of services.	Shorter physical supply chains, but not less fragmented. Decentralized governance, outsourcing More geographically distributed value added.	Much shorter and less fragmented value chains, Higher geographical distribution of activities, but + concentrated VA. + outsourcing
<b>SECTORS THAT WOULD BENEFIT THE MOST</b>	High technology intensity (automotive, machinery and equipment, electronics) Wholesale and retail trade, transportation and logistics	Medium-low technology intensity (textiles and apparel) Financial services, business services	Extractive industries, agro-based High technology intensity Regional processing (food and beverage, chemicals)	Global hub and spokes (pharmaceuticals)

Sources: UNCTAD, Allianz Research

# SCARRING EFFECTS: 2021 INITIAL CONDITIONS ARE DIFFERENT

## Strong state, redux

- State everywhere in life of business:
- More public-private partnerships
  - Assertive and interventionist governments and regulators, also in social security
  - Fiscal politics: threat of zombification

## Cold war, reloaded

- Geopolitical rivalry between China and the US has increased
- Weaponizing of technology, trade, currencies, payments etc.
- EU alone in pursuit of principled recovery (green, equitable)

## Zero interest rates, for longer

- Monetary policy as backstop for banana markets and excessive risk-taking by debtors and investors
- New wealth inequalities (access to property, savings opportunities)
  - Faustian fiscal-monetary bargain

## Agility+

- Record-fast adaption to lockdowns unleashed new pioneering spirit
- Change becomes much faster, including digital leapfrogging
  - Reset mentality v. sticky economics

## Consuming (risks) differently

- More demand for risk cover, including tail risks but unsure about price of risk
- Different consumption patterns and Covid19-induced behaviors in services
  - Climate risk sensitivity up

## Work from home anyone?

- Lockdowns have changed the way we work for good
- More flexible and innovative team structures
  - Risks to commercial real estate and productivity

# CAPITAL MARKETS: IS THERE A PRICE?

# 02



# CAPITAL MARKETS: NOT THE TIME TO TAKE RISKS

1. There is greater economic uncertainty than at the beginning of the year despite the current monetary and fiscal policy mix.
2. There is more geopolitical risks than at the beginning of the year.
3. Valuations are tighter than at the beginning of the year.

## Sovereign Rates

With the short-end of most developed countries' yield curves anchored by their respective central banks, we expect a timid curve steepening towards the end of 2020 and 2021. This gradual increase in term premium will occur on the back of higher inflation expectations and a halt in the recent decline of real yields.

On the other hand, long-term emerging market sovereign spreads look overbought. The combination of this extreme bullish positioning and the current market fragility is a perfect combination for EM assets to become a victim of a second "risk-off" rotation in the wake of a second risky-assets market correction.

## Corporate Credit

As of today, both investment grade and high yield corporate spreads look too tight. Corporate credit markets remain detached from fundamentals on the back of the central banks' perpetual put option. We expect corporate spreads to converge towards higher values on the back of higher than expected market volatility and defaults.

## Equities

Due to the persistent detachment from its fundamental determinants, the recent global equity market rally is hardly justifiable. Because of that, we still expect EQ market to underperform in 2020 and to start a muted rally in 2021.

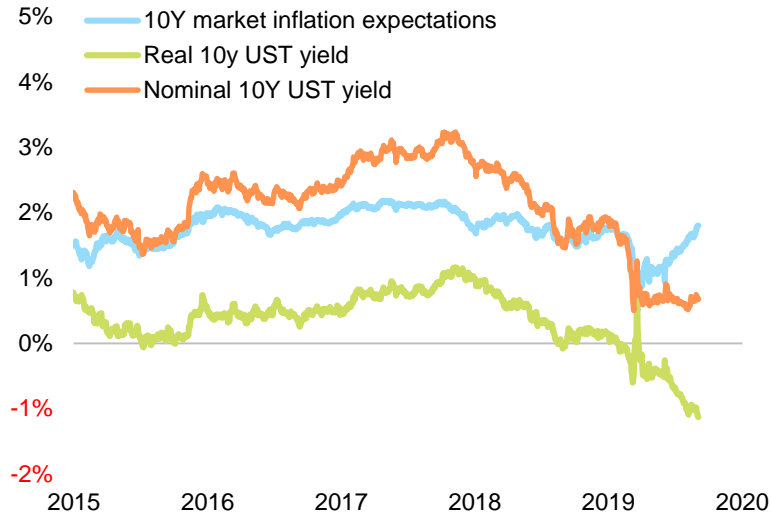
year-end figures	Latest Value	Unit	2020	2021
<b>Eurozone</b>				
<b>Sovereign Rates</b>				
<b>10y yield "risk-free" sovereign (Bunds)</b>	-0.5	%	-0.5	-0.3
<b>10y Swap Rate</b>	-0.2	%	0.0	0.3
<i>Italy - Germany spread (10y)</i>	148	bps	175 (220)	160 (170)
<i>France - Germany spread (10y)</i>	27	bps	40 (90)	30 (40)
<i>Spain - Germany spread (10y)</i>	75	bps	90 (110)	80 (70)
<b>Corporate Credit Spreads</b>				
<b>Investment grade credit spreads</b>	113	bps	180	150
<b>High yield credit spreads</b>	438	bps	750	600
<b>Equities</b>				
<b>MSCI EMU: total return p.a.</b>	-9	%	-22	10
<b>United States</b>				
<b>Sovereign Rates</b>				
<b>10y yield "risk-free" sovereign (Treasuries)</b>	0.7	%	1.0	1.4
<b>Corporate Credit Spreads</b>				
<b>Investment grade credit spreads</b>	136	bps	230	180
<b>High yield credit spreads</b>	514	bps	800	650
<b>Equities</b>				
<b>MSCI USA: total return p.a. in USD</b>	3	%	-20	15
<b>Emerging Markets</b>				
<b>Sovereign Rates</b>				
<b>Hard Currency Spread (USD)</b>	341	bps	450	370
<b>Equities</b>				
<b>MSCI EM: total return p.a. in USD</b>	-4	%	-24	20

\* Old forecasts in parenthesis

\*\* We have reviewed our EUR spreads down as the ECB impact on peripheral spreads was larger than anticipated.

# BOND MARKETS: PRICING STAGFLATION!

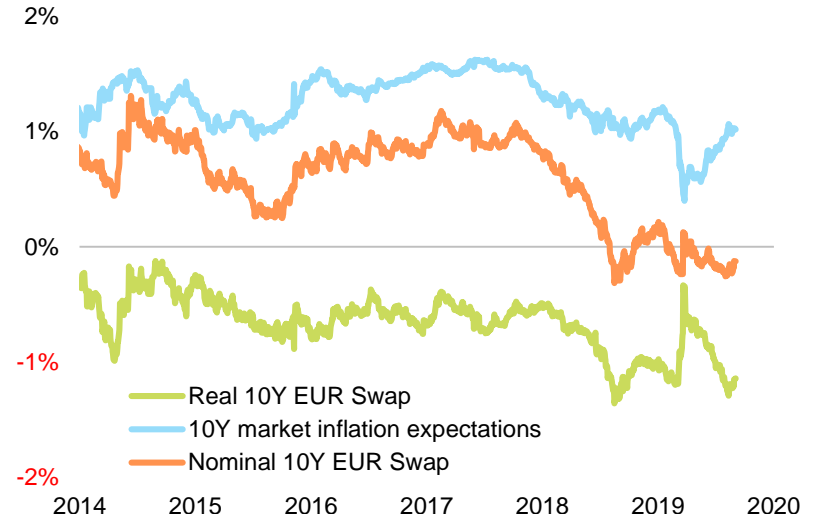
US – 10y Nominal Yield Breakdown



Source: Refinitiv, Allianz Research

Despite the recent repricing of long-term inflation expectations, nominal yields have barely bulged thanks to a fall in real yields. To put current levels into perspective, at -1.1% real yields, are now at the lowest point in recorded history. The current bearish growth positioning within the US government bond market contrasts with the recent equity market exuberance, fuelling doubts about the short- to mid-term equity market rally sustainability.

EMU – 10y Nominal Yield Breakdown



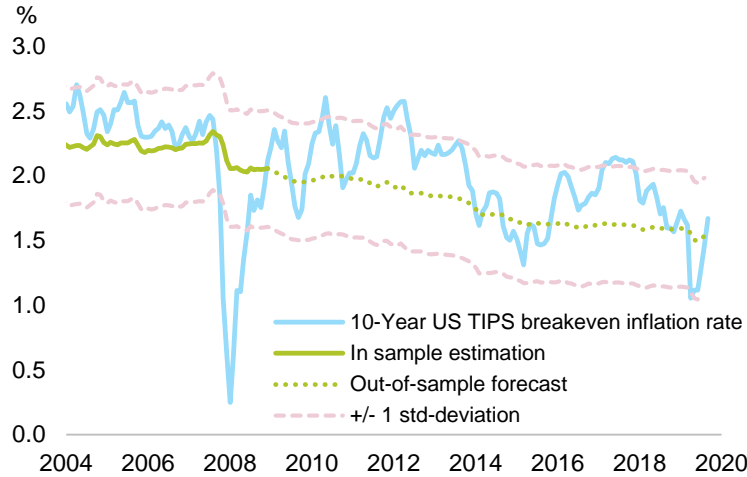
Sources: Refinitiv, Allianz Research

As in the US, long-term inflation expectations in the EMU have been rising while real yields remain at historical lows. All in all, US and EUR government bond markets are unwilling to believe in a rapid economic recovery scenario and are rather positioned for a stagflation scenario.



# INFLATION EXPECTATIONS: BACK TO SQUARE ONE!

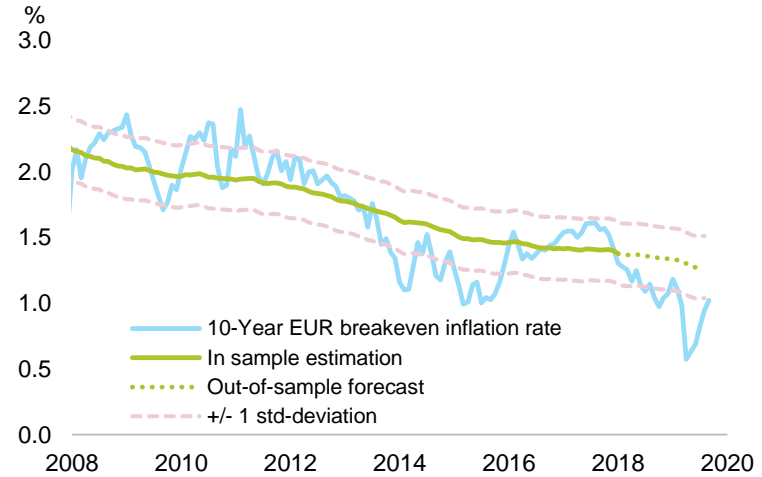
## US – 10y Market-based Inflation Expectations



Source: Refinitiv, Allianz Research

The recent increase in Oil and employment has led US long-term inflation expectations to follow a V-shaped trajectory around their March low. Since the trough, inflation expectations are on an upward trajectory exacerbated by the recent Fed's decision to target an *average* inflation rate of 2%, (i.e. allowing some overshooting above 2%). According to our "fair value" estimation, inflation expectations are unlikely to substantially overshoot the 2% upper limit.

## EMU – 10y Market-based Inflation Expectations



Sources: Refinitiv, Allianz Research

In contrast to the US case, EUR long-term inflation expectations are nowhere near their "fair value", as monetary stimulus has not convinced market participants. According to our model, EUR inflation expectations could still move closer to 1.5% in the near future, but any overshoot beyond that level would not be sustainable.

# PRICES: DISINFLATION BEFORE MODERATE AND TEMPORARY OVERSHOOT STARTING IN 2022

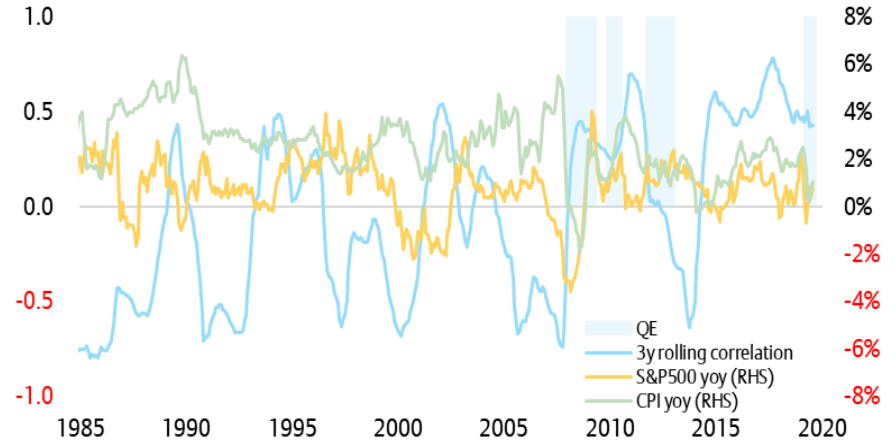
Inflation rates, %

	2020	2021	2022	2023
<b>Eurozone</b>				
Central scenario	0.3	0.9	1.2	1.4
Protracted crisis	-0.1	-1.5	-1.2	-1.1
<b>United States</b>				
Central scenario	1.1	1.6	2.1	2.7
Protracted crisis	0.5	-0.4	0/7	0.7

Sources: Allianz Research

In the short-term we expect disinflationary pressures to prevail as supply recovers faster than demand. A temporary and moderate overshoot is expected in the US as soon as mid-2022 as the economy returns to pre-crisis levels end-2021

Correlation between US inflation rates and equity

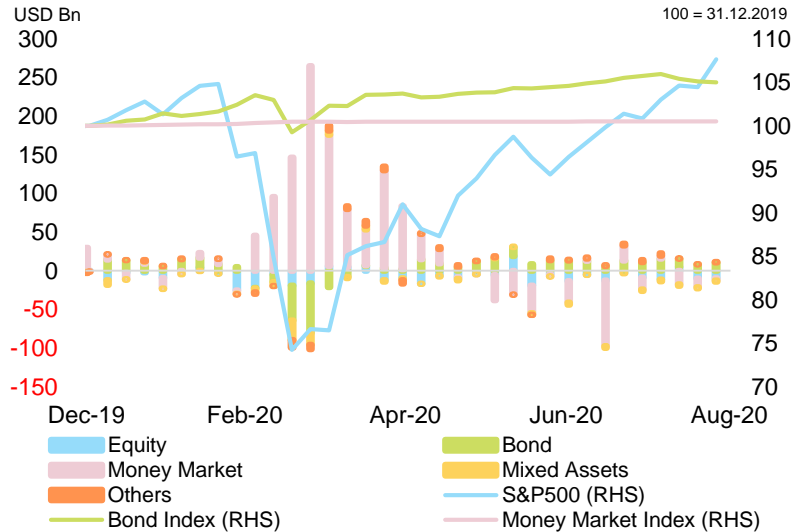


Sources: Allianz Research

Historically, US inflation levels persistently higher than 3% or lower than 0% tend to go in sync with a substantial equity market correction.

# INVESTMENT POSITIONING: WHERE ARE THE BULLS?

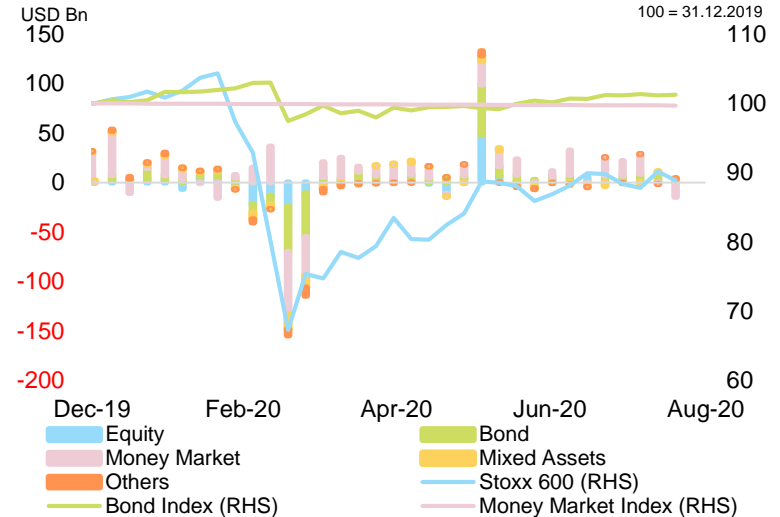
## US – Mutual Funds & ETF Weekly Investment Flows



Source: Refinitiv, Allianz Research

The recent US equity market frothiness is relatively hard to explain as both mutual fund and ETF flows show persistent transfers from Equity funds towards Fixed Income and Money Market funds. This is a symptom of the current market fragility as structural long-term investors seem unwilling to participate in the market, thus leaving the floor to stock pickers and option traders.

## EMU – Mutual Funds & ETF Weekly Investment Flows

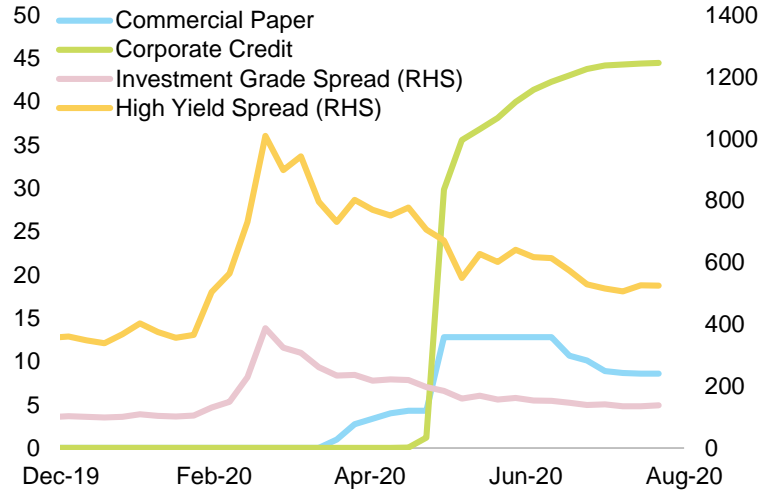


Sources: Refinitiv, Allianz Research

Differently, the Eurozone equity market does not show any signs of market exuberance (yet) as most EUR equity indices have settled around -10%ytd. Nevertheless, looking at fund flow data, one can see a small acceleration in the inflows into EUR EQ funds, with Germany and France leading the pack.

# CORPORATE CREDIT: HARD TO KEEP A PROMISE

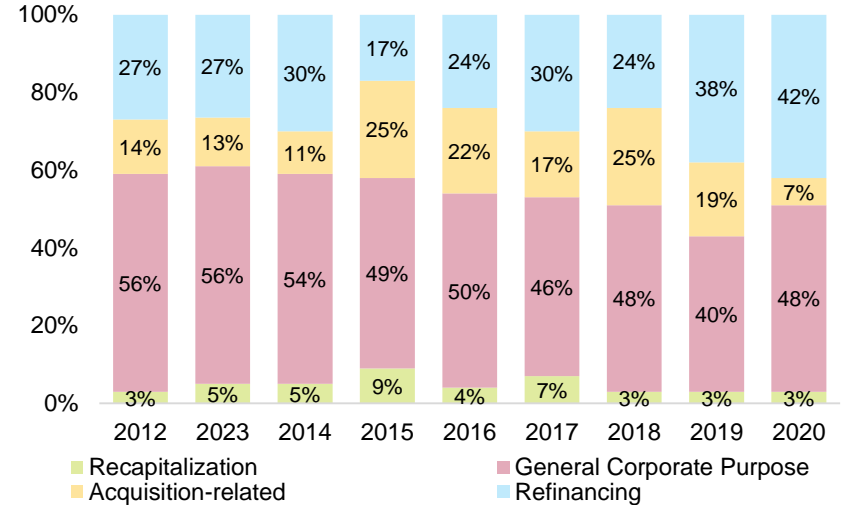
## US – Fed Corporate Purchases



Source: Refinitiv, Allianz Research

Since April, the US Federal Reserve has bought up to ~45Bn worth of corporate credit. However, since the beginning of July, the Fed has significantly reduced its weekly purchases as credit markets are once again extremely tight. Yet, credit markets spreads have not reversed back to pre-Covid19 levels and remain 10 to 20% above pre-pandemic levels.

## US IG Issuance – Use of Proceeds

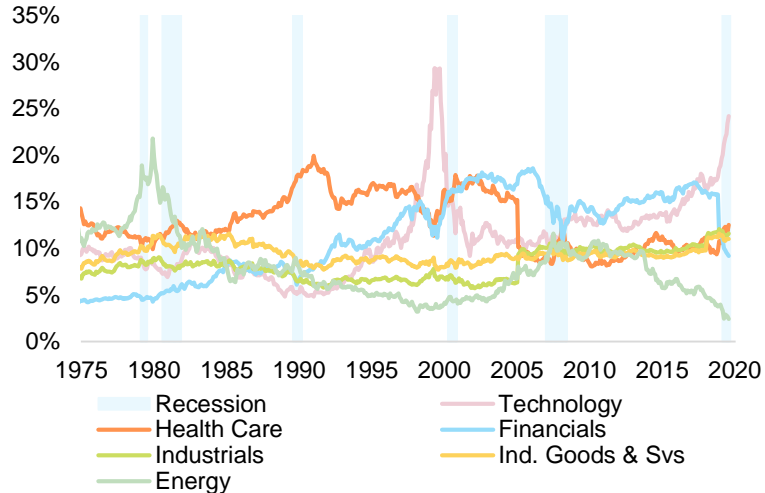


Sources: S&P, Morgan Stanley, Allianz Research

The \$1.919tn US corporate credit issuance in the first 9 months of 2020 has already surpassed the historical record of \$1.916tn set during the 12 months of 2017. Interestingly, most of that fresh money will most likely not be invested into the issuing companies as 42% of all new issuances are expected to be dedicated to debt refinancing purposes.

# EQUITY: TECH DOMINANT CLUSTER

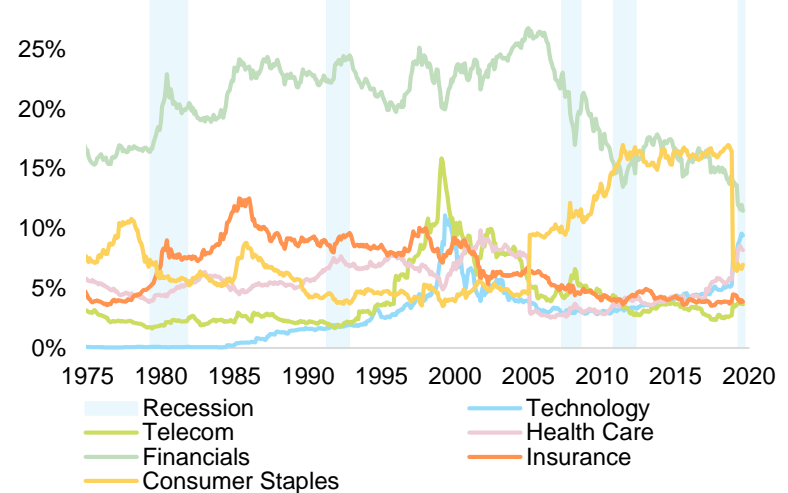
## US EQ – Sector Weightings



Source: Refinitiv, Allianz Research (Only sectors with +10% weight\*)

Historically, each financial cycle has been led by a limited group of companies usually clustered around one industry group / economic sector. These days, the technology sector accounts for more than 25% of the US EQ market capitalization\*\*. Additionally, the concentration risk is higher since, not only the sector accounts for more than one fourth of the index, but the number of companies within the sector itself has been reduced by 20 to 40% since the Dot-com bubble.

## EMU EQ – Sector Weightings



Source: Refinitiv, Allianz Research (Only sectors with +5% weight)

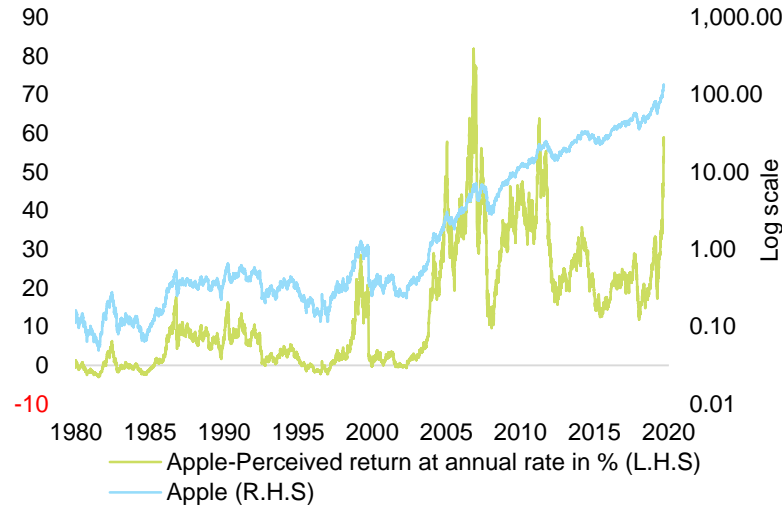
In the case of the Eurozone, the Equity market has been permanently dominated, in terms of weight, by the financial sector. Nevertheless, this dominance is starting to be questioned by the technology and health care sector, as their respective weights within the market have increased since the 2008 Great Financial Crisis.

\* Sudden jumps in weightings are due to sector reclassification.

\*\* Weights are based on the Datastream-Refinitiv Equity sector indices.

# EQUITY EXUBERANCE: HIGH EXPECTATIONS!

Apple – Return expectations



Source: Refinitiv, Allianz Research

The equity market is falling prey to a positive feedback loop whereby rising equity prices increase the demand for equities, which in turn fosters further rises in prices. We estimate, for example, that the recent performance of Apple leads market participants to expect a 56.7% annual return from Apple. In the past, this perceived return has been higher in only 1.2% of observations (i.e. 6 days out of 500).

Market Expectations

	02.09.2020	Price	Expected annual rate of return (%)	Relevant past data for current return determination (in years)
Alphabet-Google		1,717.39	21.5	3.62
Amazon		3,531.45	56.0	1.66
Apple		131.40	56.7	1.58
Bitcoin		11,398.44	46.1	1.79
Oil Brent		44.51	-0.8	24.21
Facebook		302.50	20.9	3.64
Gold		1,940.23	7.6	7.27
Microsoft		231.65	33.3	2.50
Netflix		552.84	46.7	1.86
Tesla		447.37	228.2	0.60
TRY to 1 USD		7.38	18.4	3.92
Zoom Video Comm.		423.56	38.7	1.97

Sources: Allianz Research

As this expectation disproportionately depends on recent price movements (the ones observed during only the last 1.6 years), it is inherently unstable. Furthermore, as the Apple stock is already trading at a multiple of 40, little appreciation is to be expected from further PE expansion; EPS growth will be the main driver of its future return, but a 50%+ earnings growth looks ambitious and unsustainable.



**THE U.S. PIVOT, CHINA RELOADED,  
AND THE ALMOST UNITED STATES  
OF EUROPE**

**03**

# US ELECTIONS: 4 SCENARIOS



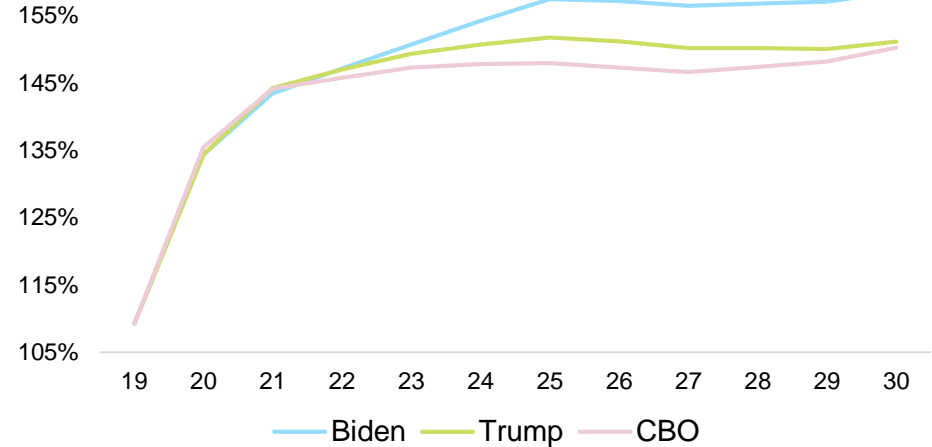
Scenario	Biden large victory	Biden short victory	Trump short victory	Trump large victory
Probability	20%	40%	30%	10%
Scenario description	<ul style="list-style-type: none"> <li>President Trump cannot make any fraud claims.</li> <li>Democrat majority in congress, in the house as well as in the senate.</li> <li>Rapid voting of a USD 3.7 trillion package over the ten coming years.</li> </ul>	<ul style="list-style-type: none"> <li>President Trump victory claim before full counting of ballots</li> <li>Fraud claim once Biden's victory is revealed.</li> <li>Final validation from the Supreme Court 1 to 2 months after the election possible.</li> <li>No clear majority in the Congress. The house keeps a Democrat majority and the senate keeps a Republican majority.</li> <li>Negotiation blockade on the budget in the Congress maintains a possibility of shutdown until Q2 2021.</li> </ul>	<ul style="list-style-type: none"> <li>Biden refuses verdict – argues for Russia interferences, potential voting fraud, institutional pressures, and voter suppression laws.</li> <li>No clear majority in the Congress. The house keeps a Democrat majority and the senate keeps a Republican majority.</li> <li>Validation from the Supreme Court 1 to 2 months after the election possible.</li> </ul>	<ul style="list-style-type: none"> <li>Joe Biden cannot make any fraud claims.</li> <li>Whole congress turns Republican.</li> </ul>
Economic impact	<ul style="list-style-type: none"> <li>New investment cycle with big infrastructure projects and redistributive policies.</li> <li>Decline of unemployment rate at 5.5% by the end of 2022 (8.4% today).</li> <li>US GDP growth at -5.3% y/y in 2020, +4.2% y/y in 2021 and 3% in 2022.</li> </ul>	<ul style="list-style-type: none"> <li>Less ambitious program. Consensus on Infrastructure projects but lower re-distribution in favor of households, not fulfilling of the promise of increasing corporate tax rate from 21% to 28% (halfway).</li> <li>US GDP growth comes at -5.3% in 2020; +3.7% in 2021 and +2.5% in 2022.</li> </ul>	<ul style="list-style-type: none"> <li>Supply-side policy, extended tax cuts for individuals, smaller size Infrastructure projects. Uncertainty on external policy, perspective of harsher tone on China and re-shoring weighs on the investment cycle despite tax cut announcements.</li> <li>Bold moves on the external side (technology cold war, tariffs, and sanctions on US companies located abroad) penalizes growth (-5.3% in 2020; +1.7% in 2021 and +1.2% in 2022).</li> </ul>	<ul style="list-style-type: none"> <li>Tax cuts, new protectionist measures, bipartisan adoption of infrastructure program, but less extensive than Biden because of a less ambitious green plan.</li> <li>US GDP growth comes at -5.3% in 2020, 2.7% in 2021, 1.8% in 2022.</li> </ul>
FED response	<ul style="list-style-type: none"> <li>FED balance sheet levels off as early as Q1 2021 after a steady increase since Q4 2020.</li> <li>First rate hike as early as Q3 2022.</li> </ul>	<ul style="list-style-type: none"> <li>FED balance sheet increases until end-Q2 2021 (to alleviate significant amount of uncertainty) then levels off.</li> <li>First rate hike from Q3 2023 only.</li> </ul>	<ul style="list-style-type: none"> <li>FED balance sheet increase until end Q3 2021, then levels off. Political uncertainty is as high as in the short Biden victory scenario.</li> </ul>	<ul style="list-style-type: none"> <li>FED balance sheet levels off as early as Q2 2021 after a steady increase since Q4 2020.</li> <li>First rate hike as early as Q4 2023.</li> </ul>
USD	<ul style="list-style-type: none"> <li>The dollar is set to depreciate versus the EUR by up to 2,5% within the next 12 months;</li> <li>Then re-appreciates by 4-6% one year later.</li> </ul>	<ul style="list-style-type: none"> <li>The dollar is set to depreciate versus the EUR by up to 5% (-1.25) within the next 12 months;</li> <li>Then re-appreciates by 2-3% one year later.</li> </ul>	<ul style="list-style-type: none"> <li>The dollar is set to depreciate versus the EUR by up to 7,5% within the next 12 months;</li> <li>Then re-appreciates by 2-3% one year later.</li> </ul>	<ul style="list-style-type: none"> <li>The dollar is set to depreciate versus the EUR by up to 10% within the next 12 months;</li> <li>Then re-appreciates by 4-6% one year later.</li> </ul>
10 year treasury yield	<ul style="list-style-type: none"> <li>1,25% at the end 2020; 1,8% at the end of 2021.</li> </ul>	<ul style="list-style-type: none"> <li>1% at the end 2020; 1,4% at the end of 2021.</li> </ul>	<ul style="list-style-type: none"> <li>1% at the end 2020; 1,4% at the end of 2021.</li> </ul>	<ul style="list-style-type: none"> <li>1,15% at the end 2020; 1,6% at the end of 2021.</li> </ul>

# US ELECTIONS: SMALLER GOV. VS. BIG SPENDING



TRUMP		BIDEN	
<b>SPENDING, \$bn (-2965)</b>		<b>SPENDING, \$bn (+6435.85)</b>	
<b>1275</b>	Infrastructure	<b>970</b>	Infrastructure (not elsewhere)
<b>-125</b>	Higher education	<b>2000</b>	Climate change
<b>-280</b>	Reform welfare programs & increase parental leave	<b>750</b>	Student loans
<b>-1550</b>	Discretionary, non-defense	<b>1650</b>	Health
<b>-400</b>	Discretionary, defense	<b>128.2</b>	Schools
<b>-1630</b>	Health	<b>23.6</b>	Defense
<b>-255</b>	Other spending cuts	<b>240.5</b>	Public-private investment
<b>REVENUE, \$bn (-1085)</b>		<b>640</b>	Housing plan
<b>-1370</b>	Tax decrease	<b>33.55</b>	Other spending increases
<b>185</b>	Reduce tax incentives & raise fees	<b>REVENUE, \$bn (+3686)</b>	
		<b>3746</b>	Tax increases
		<b>-60</b>	Increase tax incentives

U.S. public debt, % of GDP

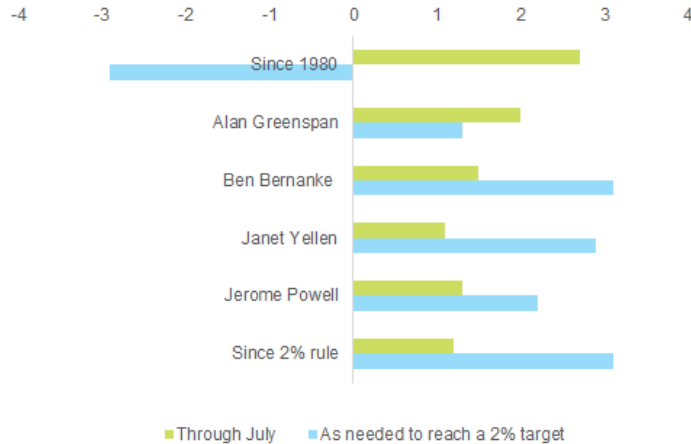


President Trump's intentions point towards a supply-side oriented policy. Joe Biden's economic platform gives more weight to higher redistribution, but won't stand as the most leftist aspects of his entire platform.

Both candidates have no real intention to reduce the level of public debt. We expect them to make public debt significantly increase above 150% of GDP by 2030, which should cause a negative impact on growth potential.

# AVERAGE INFLATION TARGETING: BUYING TWO YEARS FOR THE US ECONOMY

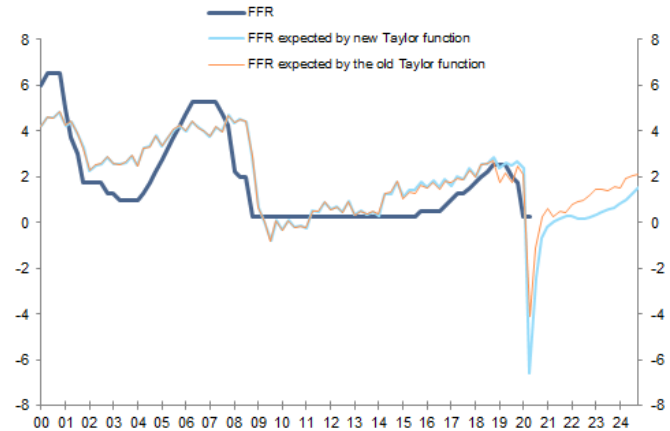
Average performance of the Fed in terms of inflation (%)



Sources: Wall Street Journal, Euler Hermes, Allianz Research

Since adoption of its 2% inflation target, the Fed has constantly failed in reaching it. In order to be credible, the Fed had no choice than rebalancing in favor of its full employment mandate.

Fed's Taylor function

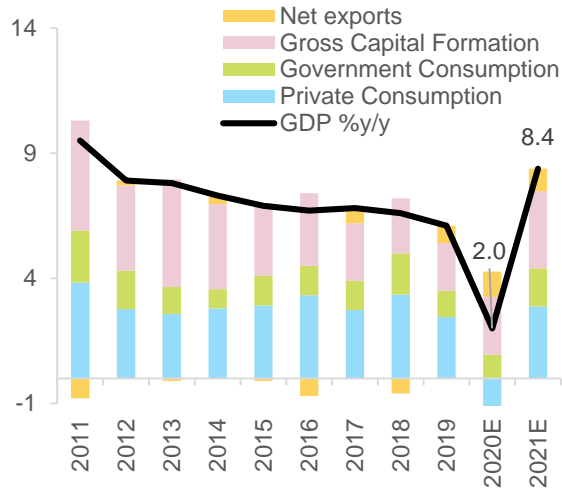


Sources: Euler Hermes, Allianz Research

For every quarter when 4-year average inflation is below 2%, we incrementally rebalance the Taylor function in favor of job market stabilization. In this case, the first hike of the Fed is expected in Q3 2023 only.

# CHINA'S RECOVERY: UNEVEN BUT RESILIENT

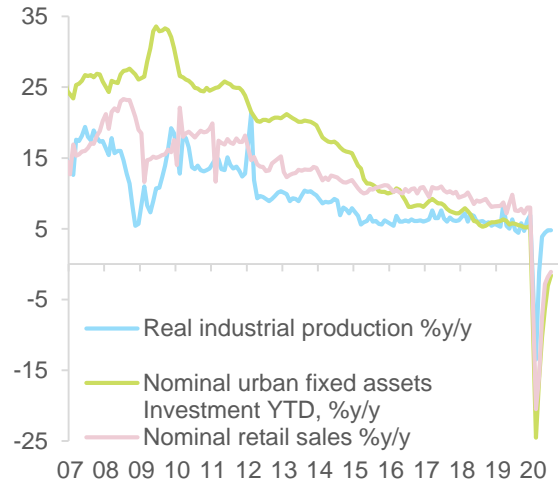
GDP growth (%) and contributions (pp)



Sources: National sources, Euler Hermes, Allianz Research

After the initial Covid-19 related shock in Q1, the Chinese economy has surprised on the upside – in part thanks to resilient exports. We expect the recovery to extend into 2021.

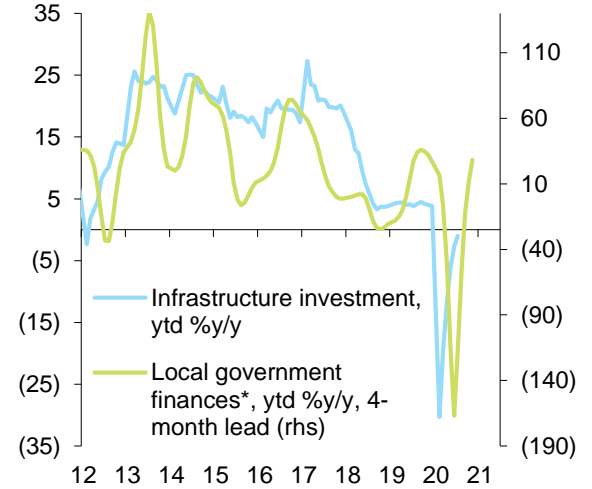
Activity indicators growth, %/y



Sources: National sources, Euler Hermes, Allianz Research

The recovery has been uneven so far, being largely driven by the production side, against consumers still showing low confidence and a hit to disposable income.

Fiscal support & infrastructure investment



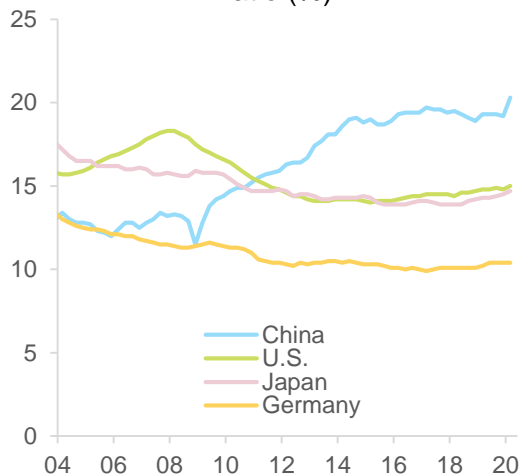
Sources: National sources, Euler Hermes, Allianz Research

The recovery is mostly policy-driven, with in particular infrastructure and real estate investment outperforming. We estimate fiscal support at 7.1% of GDP in 2020. We expect smaller but still large support in 2021 (c.5.5%).

# CHINA'S POLICY EASING IS PEAKING



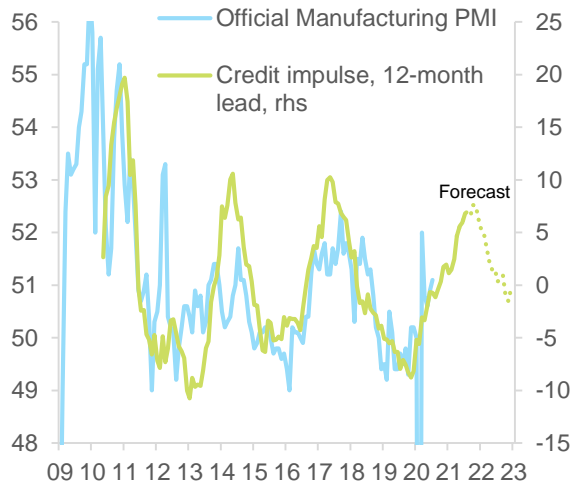
Private non-financial sector debt service ratio (%)



Sources: BIS, Euler Hermes, Allianz Research

China's debt service ratio had increased rapidly following the GFC, before stabilizing from 2016 thanks to supply side reforms. The Covid-19 crisis is putting upside pressures on the ratio again.

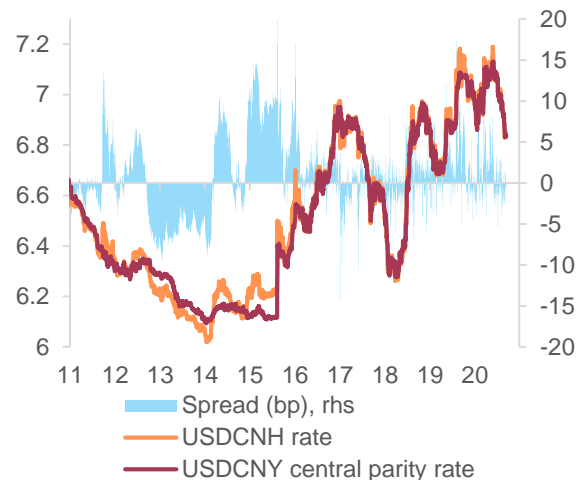
Credit impulse & manufacturing PMI



Sources: National sources, Euler Hermes, Allianz Research

As the economic recovery is well underway, the PBOC's focus could gradually turn to structural issues again. We thus expect the peak of monetary easing to be reached in coming months.

FX rates



Sources: Macrobond, Euler Hermes, Allianz Research

In a context of China leading the global recovery, and policy easing peaking, we expect further room for appreciation for the CNY vs. the USD, by c.3% over the coming year (USDCNY towards 6.6).



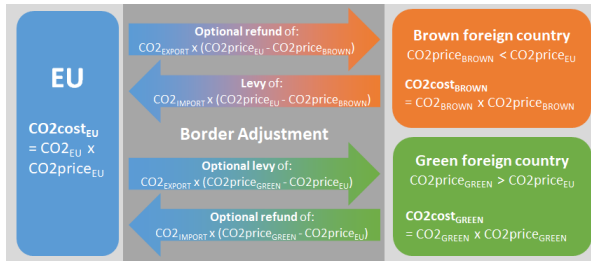
# BREXIT: A LAST-MINUTE COMPROMISE



	Soft Brexit with very-last minute compromise and FTA implementation by mid-2021 (55%)		Hard Brexit on Jan 1 <sup>st</sup> , 2021 with likely comeback into negotiations during 2021 after early elections (45%)	
	2020	2021	2020	2021
<b>GDP growth, %</b>	<b>-11.8</b>	<b>+2.5</b>	<b>-10.9</b>	<b>-4.8</b>
Consumer spending, %	-13.3	5.9	-12.0	0.7
Total investment, %	-26.8	-15.1	-26.8	-25.8
Exports, %	-13.7	1.8	-13.7	-13.0
Inflation	0.7	1.5	0.7	4.5
Unemployment rate	7.0	8.5	7.0	10.0
GBP/EUR, annual change	-2.0	-3.0	-2.0	-10.0
Business insolvencies, %	4.0	31.0	4.0	53.0
Monetary policy	QE increased by 5% of GDP (around GBP100bn) and implemented until mid-2021, rates unchanged at 0.1%		Rates cut into negative territory and QE increased by GBP250-300bn, similar to the Covid-19 package	
Fiscal policy	2% of GDP in 2021 (after only 1.5% in 2020) mainly focused on infrastructure spending and tax cuts		4% of GDP in 2021 mainly focused on infrastructure spending and measures to protect consumers purchasing power. State guaranteed loans prolonged until end-2021.	
Gilt expectations and equity strategy	10y GILT at 0.4%(eoy) FTSE 100 at -22%yoy (eoy)	10y GILT at 0.6%(eoy) FTSE 100 at +10%yoy(eoy)	10y GILT at -0.2%(eoy) FTSE 100 at -50%yoy (eoy)	10y GILT at 0.1%(eoy) FTSE 100 at -10%yoy(eoy)

# EUROPE: A CARBON TAX FOR A PRINCIPLED RECOVERY?

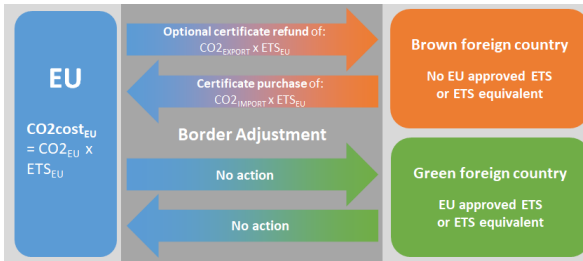
## Option 1: Carbon tariff on imports



Source: Allianz Research

- Tariff on implicit CO<sub>2</sub> content of traded intermediates and final goods
- WTO conformity requires comparable pricing of domestic goods
- Possibility to “subsidize” exports to brown countries
- Other carbon payments can be deducted
- Improves competitiveness of EU industry

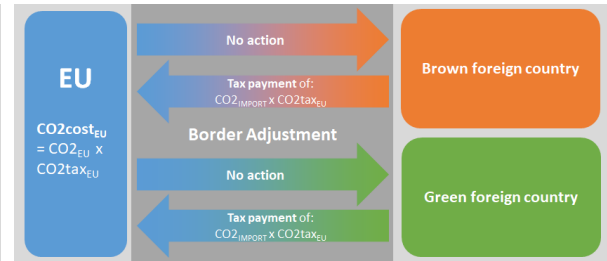
## Option 2: Extension of EU ETS to imports



Source: Allianz Research

- Purchase of certificates for implicit CO<sub>2</sub> content of traded intermediates and final goods
- WTO conformity requires abandoning EU free allocation practice
- Possibility to “subsidize” exports to brown countries
- Other carbon payments can be deducted
- Improves competitiveness, endorsed by French government

## Option 3: Tax on product's CO<sub>2</sub> content



Source: Allianz Research

- Tax on implicit CO<sub>2</sub> content of specific goods
- WTO conform
- Not possibility to subsidize exports to brown countries
- Basically just a carbon tax on some output goods

# CHINA: DUAL CIRCULATION IS ON

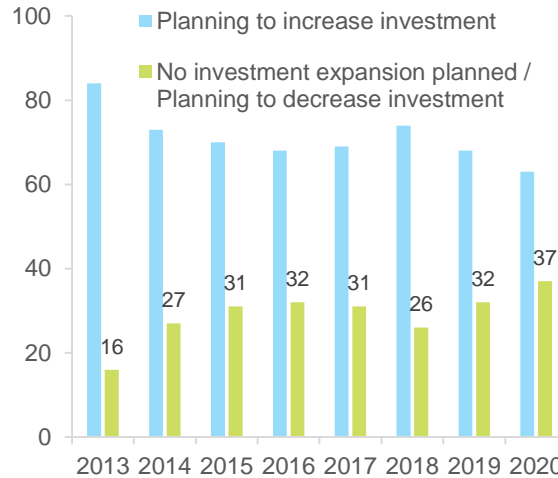
High-tech exports from domestic companies (% of total)

	2005	2012	2015
<b>All products</b>	<b>8%</b>	<b>12%</b>	<b>19%</b>
Medical equipment	14%	34%	41%
Telecoms equipment	11%	26%	26%
Electronic appliances	7%	6%	16%
Semiconductors	14%	13%	14%
Integrated circuits	2%	5%	12%
Computers	1%	1%	3%

Source: Kennedy, *The Fat Tech Dragon* (CSIS, 2017)

In the long run, China still aims to climb up the global value chain. While there have been significant improvements in the past years, there is still large room for catching-up in high-tech sectors.

U.S. companies' investment plans in China China's repackaged strategy: "dual circulation"



Source: 2020 China Business Climate Survey Report

Foreign cooperation and investment should help in the path of technological upgrade. However, the loosening U.S.-China relations could mean slowing foreign direct investment into China.

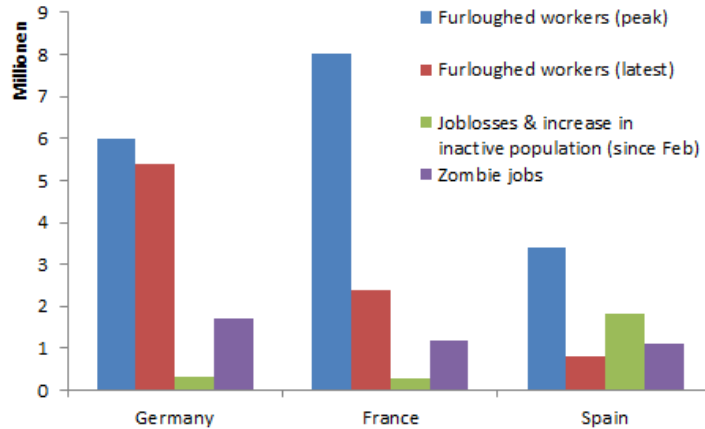
Domestic circulation	<ul style="list-style-type: none"> <li>• Reroute some Chinese exports domestically, given the crisis</li> <li>• Redirect Chinese consumers' overseas spending domestically.</li> <li>• Encourage firms to become less dependent on foreign supplies.</li> </ul> <p>→ Further investment and supportive policies for strategic high-tech sectors.</p>
International circulation	<p>Domestic circulation does not mean closing its doors to foreign firms. As of August 2020, more measures to support foreign companies have been put in place than over all 2019.</p> <p>→ More reforms to liberalize the capital account, support foreign investment (especially in the services sector).</p>

Source: Euler Hermes, Allianz Research

In May, China rebranded its long-term strategy of industrial upgrade and self-sufficiency into the expression "dual circulation". The focus is still on domestic high-tech and foreign investment.

# EUROZONE: LABOR MARKET FAR FROM OUT OF THE WOODS, EU FUNDS COULD CUSHION PAIN

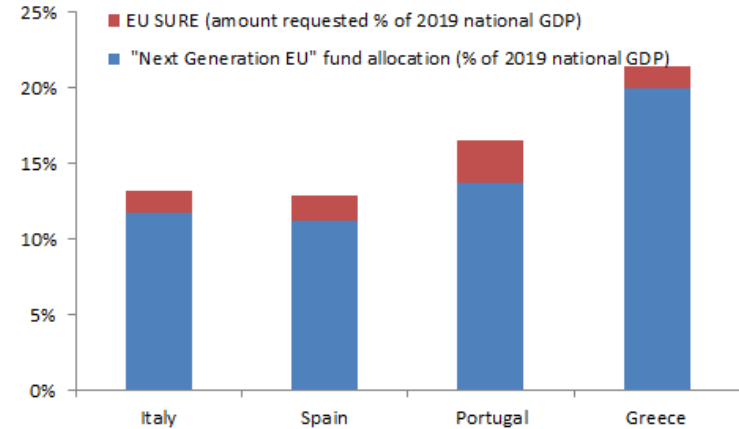
Number of furloughed workers, increase in unemployment & inactive population and zombie jobs



Sources: Eurostat, Allianz Research

In many large EU countries furlough schemes have been extended until 2021. While this is good news for the short-term economic outlook, policymakers are not yet doing enough to mitigate the risk of zombie jobs (reskilling, hiring incentives etc.).

EU support funds (% of 2019 national GDP)



Sources: EU Commission, Allianz Research

The great equalizer? EU funds could provide important economic tailwind in the most impacted economies, but implementation risk remains a key downside risk.

# EUROZONE: INVESTMENT, THE LAST MAN RISING IN THE RECOVERY

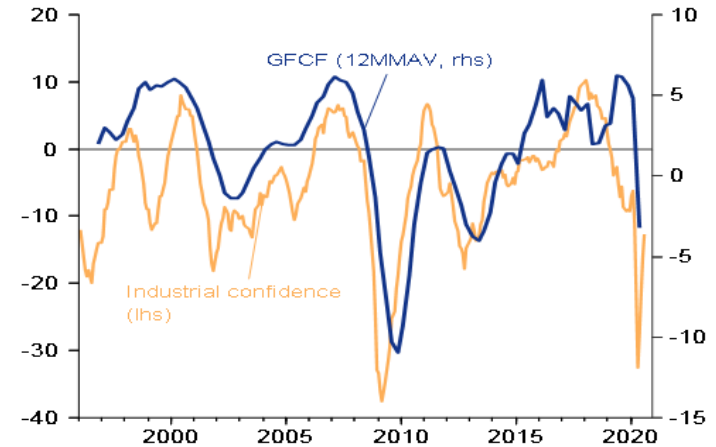
NPL loss simulations (2019-2021)

	Dec 2019		Dec 2021			
	NPL ratio (%)	NPL amount (bl EUR)	NPL ratio (%)		NPL amount (bl EUR)	
			LOWER	UPPER	LOWER	UPPER
France	2.5	117.21	4.5	5.4	209.30	255.35
Germany	1.3	29.98	2.0	2.3	45.04	52.56
Italy	6.7	115.54	13.9	17.4	239.10	300.88
Spain	3.2	79.15	6.6	8.2	162.07	203.53
UK	1.3	53.59	3.3	4.3	135.45	176.38
Belgium	1.8	8.41	3.6	4.5	16.66	176.38
Netherlands	1.6	34.21	2.4	2.9	52.13	61.09
Portugal	7.6	12.74	14.1	17.3	23.58	29.00
euro zone	3.1	507.43	4.7	5.4	762.15	889.51
<b>NPL change 2019-2021</b>			<b>1.6</b>	<b>2.3</b>	<b>254.72</b>	<b>382.08</b>

Sources: Allianz Research.

Rising credit risk ( we expect NPLs to rise from 3.1% in Q4 2019 to 4.7%-5.4% by end 2021) together with the phasing out of public loan guarantees will weigh on banks' readiness to extent credit to the private sector.

Eurozone: Fixed investment vs. Industrial confidence

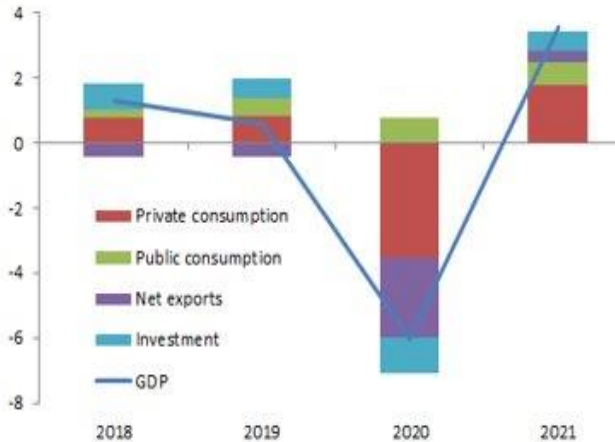


Sources: Refinitiv, Allianz Research.

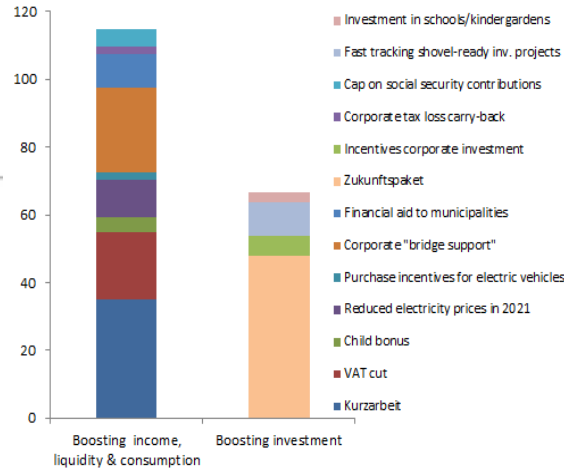
Heightened uncertainty around the economic outlook together with depressed margins will keep a lid on corporate investment in the coming months. In 2022, investment will still be 5% below pre-crisis levels.

# GERMANY: MIND COMPLACENCY

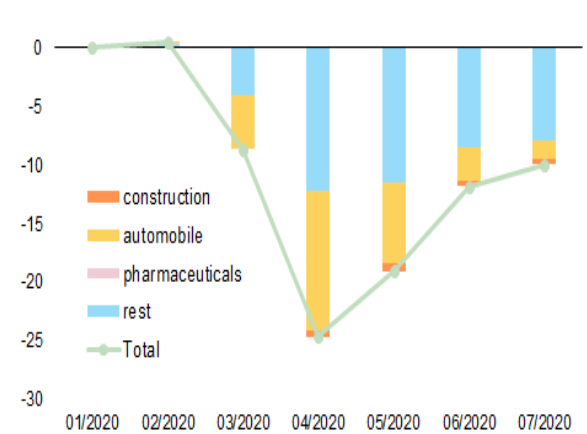
Germany: Real GDP (%) & its components (pp)



Key fiscal support measures (EUR bn)



Germany: Industrial production (change vs. Jan 2020, %)



Sources: Refinitiv, Allianz Research.

Germany's relatively resilient consumer - in part thanks to fiscal policy's focus on stimulating demand at the expense of the supply side - will drive the partial rebound in GDP in 2021, while trade will remain muted.

Sources: German Ministry of Finance, Allianz Research

No quick return to the black zero: Given the looming fiscal cliff in 2022 as most measures boosting consumption & income expire, expect the next government to cushion the impact with fresh easing measures.

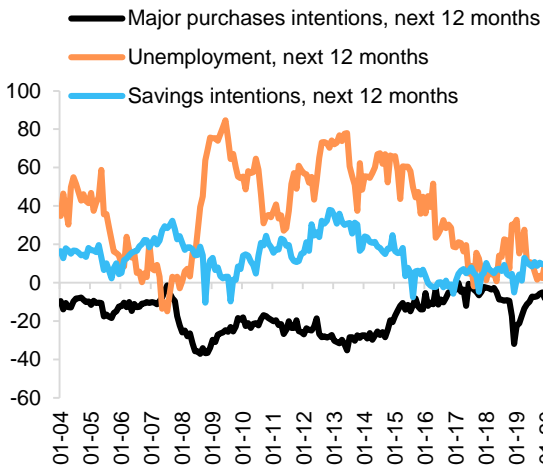
Sources: Refinitiv, Allianz Research.

The industrial rebound has been propped up by the automobile sector, but the uneven global recovery, the strong EUR and high uncertainty won't allow for a full recovery before 2022.

# FRANCE: GROWING CONCERNS FOR JOBS



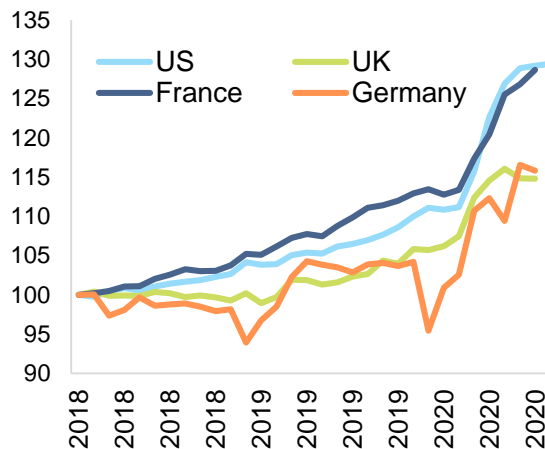
Consumer confidence survey



Sources: INSEE, Allianz Research; Latest data: August 2020

The household confidence indicator (long term average =100) decreased in July to 94 (from 96 in June) and remained stable in August.

Outstanding bank deposits (index, Jan 2018=100)



Sources: Banque de France, Allianz Research

The EUR110bn emergency package from March 2020 helped to absorb the Covid-19 shock but also fueled cash hoardings of household and companies.

Announced Phase II stimulus (EURbn)

Type of measure	Covid-19-adjusted fiscal multiplier	France	Germany	Italy*
Consumption taxes / subsidies	0.10	0	31	1
Transfers	0.10	10	14	3
Corporate taxes & competitiveness	0.50	30	13	1
Labor support (incl. partial unemployment)	0.50	20	10	12
Public consumption	0.50	15	25	3
Public investment	0.85	25	50	2

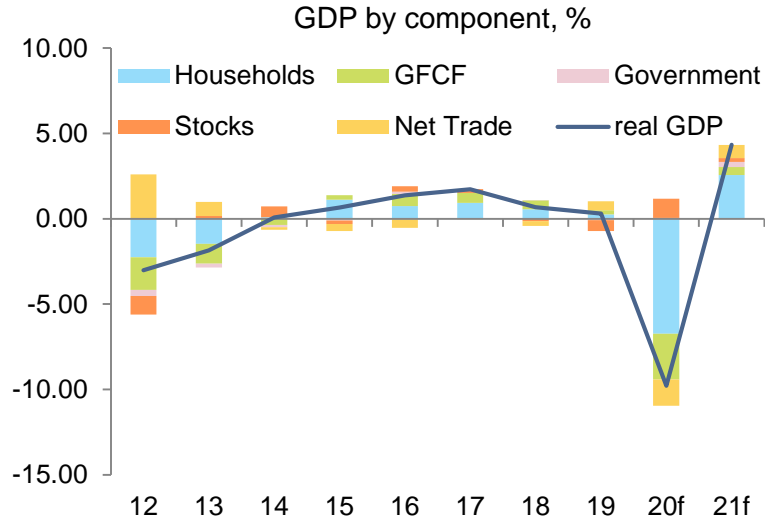
TOTAL	100	143	31
Share of GDP	4.3%	3.8%	1.5%
Country-wide fiscal multiplier	0.55	0.50	0.48
<b>Impact of stimulus on growth</b>	<b>2.4pp</b>	<b>2pp</b>	<b>0.7pp</b>

\*not all measures have been detailed, only partial categories. Totals might not add up

Sources: Euler Hermes, Allianz Research, IMF

The French structural reforms are good news for potential growth. But in the short-term, we see the largest deterioration in merchandise trade deficit (-EUR12bn over 2021-22).

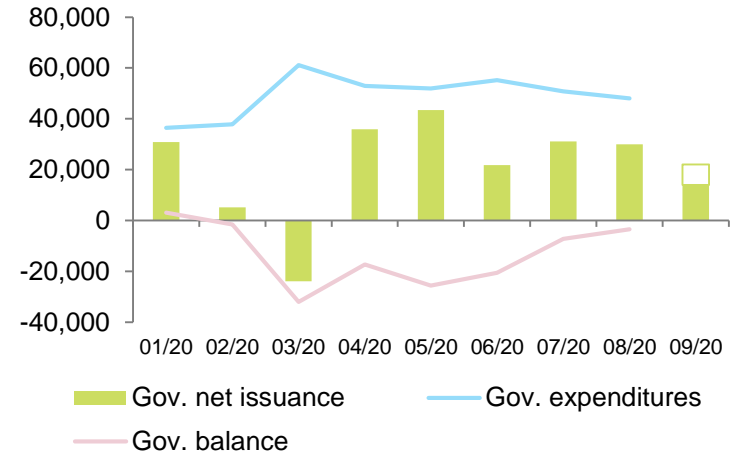
# ITALY: WORST-CASE SCENARIO AVOIDED



Sources: Refinitiv, Allianz Research

Decline in real GDP smaller than previously expected (-10.1%). Robust manufacturing recovery with good start into Q3. Challenges: Tourism (-70% international arrivals), reversing stocks, difficult transmission of guaranteed loans to SME due to banking sector weakness. In 2021, rebound of +4.3%.

Evolution of public finances (in EUR mn)



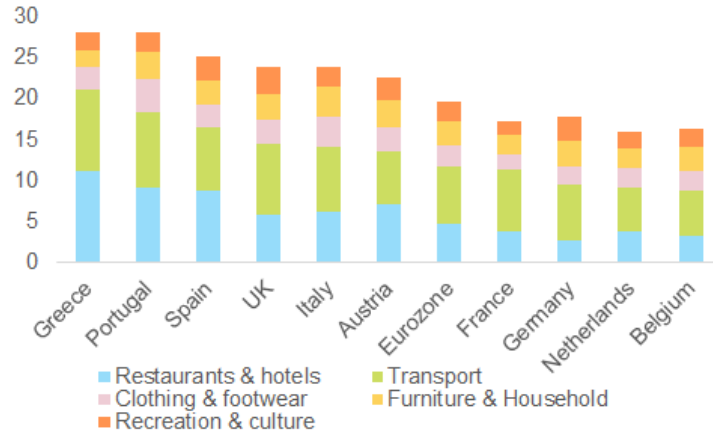
Sources: Refinitiv, Allianz Research

Additional EUR25bn fiscal package and EU RF (~200bn in loans and grants) mostly effective in 2021. Balance between maintaining short term stimulus and returning to longer term fiscal prudence as public debt will soar to 160% of GDP and primary balance remains a signal to markets. Risk of fiscal inaction in H2.



# SPAIN: THE COST OF INACTION

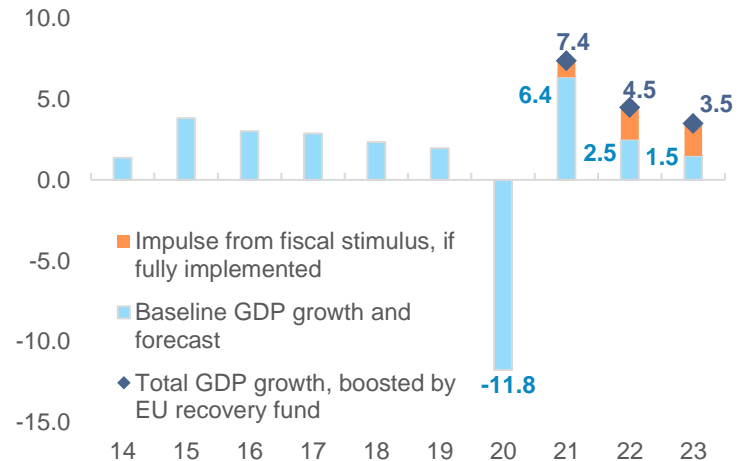
Recession & Covid-19 sensitive consumption components in % of GDP



Sources: Refinitiv, Allianz Research

In Spain, among worst hit, % of consumption at risk (hotels, culture...) is among the highest (25%). Bad omen for recovery. Seasonality of activity means the disappointing summer will also weigh on recovery.

GDP growth forecast and potential impulse from stimulus



Sources: National Statistics, IHS Data Insight, Allianz Research

Spain could receive EUR140bn from the EU recovery fund in 2021. Yet continued political fragmentation (no 2021 budget voted) should delay the “relaunch” stimulus. This could result in a shortfall of a cumulated ~5pp of GDP growth during the recovery.

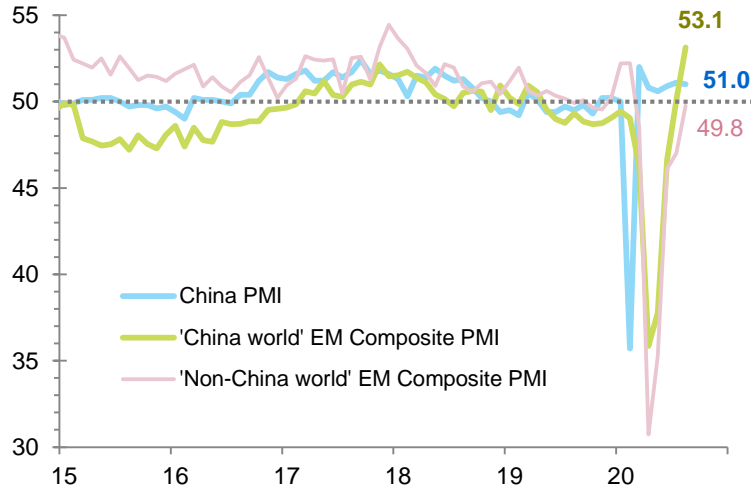
**EMERGING MARKETS:  
EXTERNAL TAILWINDS**

**04**



# EMERGING MARKETS: V-SHAPED RECOVERY IN 'CHINA WORLD', W-SHAPED ELSEWHERE

Composite Manufacturing PMIs of 'China-dependent' and 'non-China-dependent' EMs vs. China's PMI

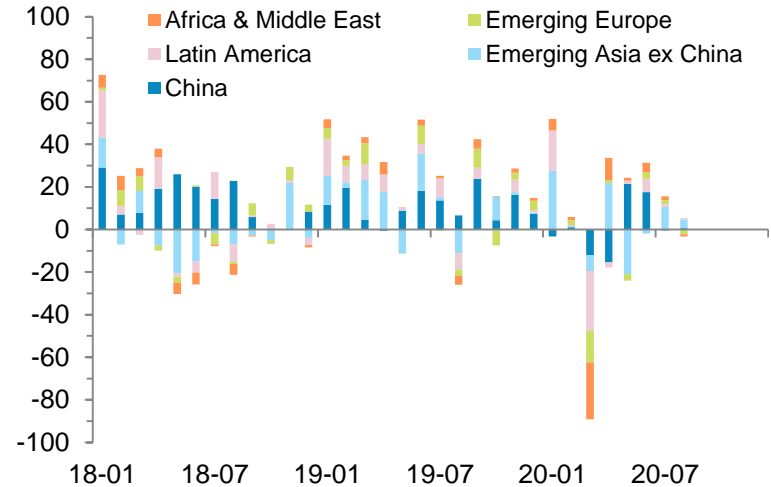


NB: 'China world' includes Taiwan, Hong Kong, Singapore, Indonesia, South Korea, Brazil, Russia, South Africa.

Sources: National statistics, IIF, Allianz Research estimates

EMs highly dependent on exports to China follow the latter's business cycle with a lag. Other EMs experienced a deeper recession and will see a slower recovery.

Net non-resident portfolio flows to EMs by region (USD bn)



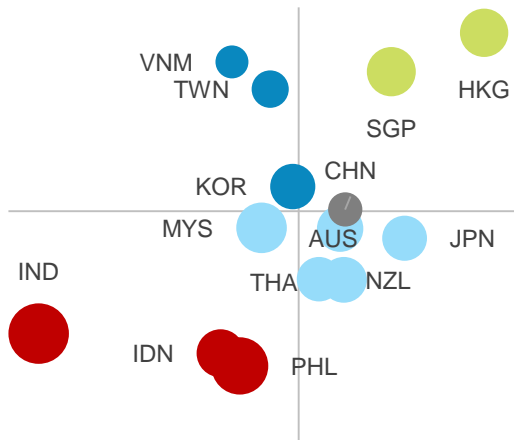
Sources: National statistics, IIF, Allianz Research estimates

Negative real interest rates should support risk appetite in the EM if no negative surprise on monetary policy or political risk. In addition, the USD depreciation (-2.5% end of 2021) and China's recovery should also be positive.



# ASIA-PACIFIC: BENEFITTING FROM CHINA'S EARLY RECOVERY CANNOT BE THE FULL STORY

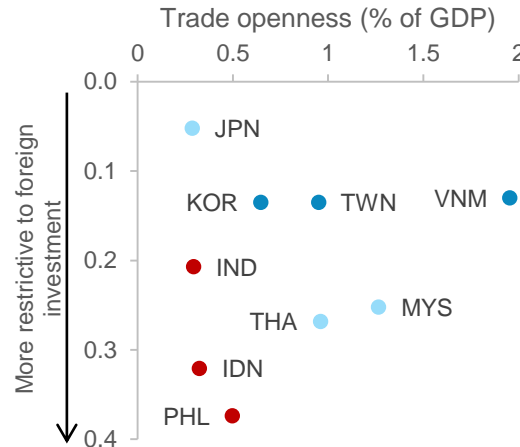
Drivers of growth: domestic (horizontal axis) vs. external (vertical axis)



Size of bubble represents Covid-19 situation and shock.  
Sources: Various, Euler Hermes, Allianz Research

The recovery path is determined by the epidemic situation, the size of the shock in H1 2020, exposure to external drivers of growth, and the strength of domestic drivers.

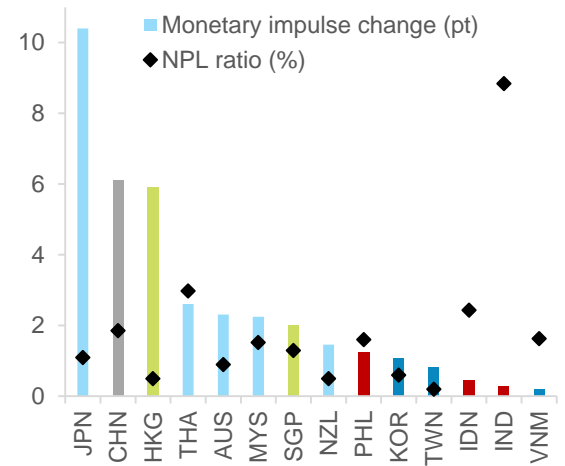
External drivers: trade openness & exposure to reshoring



Sources: Various, Euler Hermes, Allianz Research

South Korea, Taiwan, Vietnam, HK and Singapore could benefit from China's early recovery. India, Indonesia and the Philippines are comparatively less open, and could struggle more to attract foreign investment.

Domestic drivers: monetary impulse and policy leeway

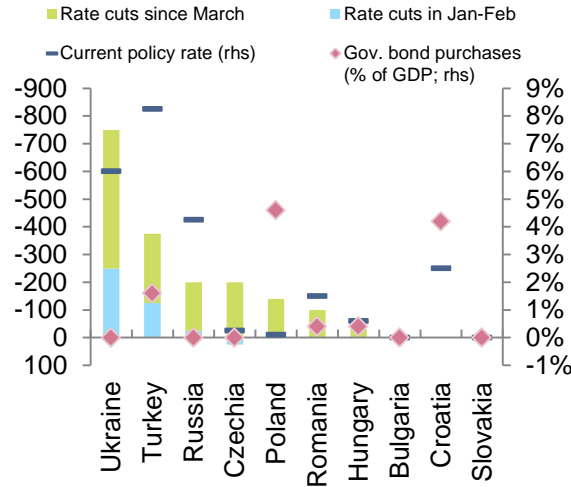


Sources: Various, Euler Hermes, Allianz Research

On top of that, their policy response has been comparatively more restrained. The policy leeway is smaller, due to structural issues.

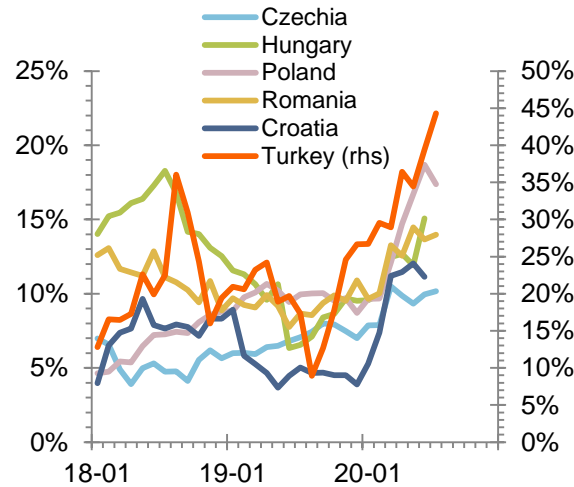
# EMERGING EUROPE: FROM SUPPORTIVE TO OVERHEATING?

## Monetary policy accommodation



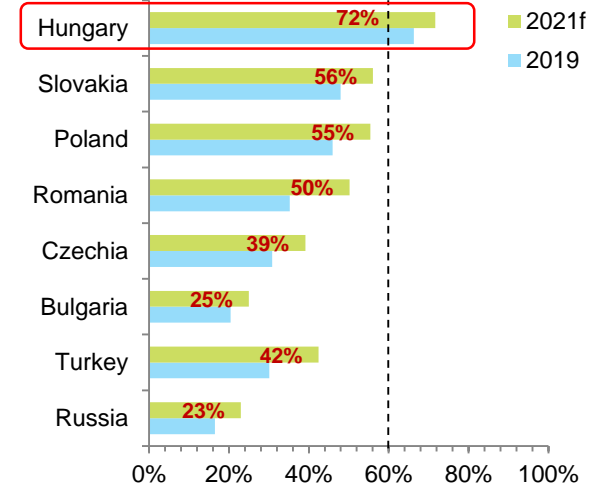
Sources: National statistics, IMF, IIF, Allianz Research

## M2 growth (% y/y)



Sources: IMF, IHS Markit, Allianz Research

## Public debt (% of GDP)



Sources: Eurostat, IMF, Allianz Research forecasts

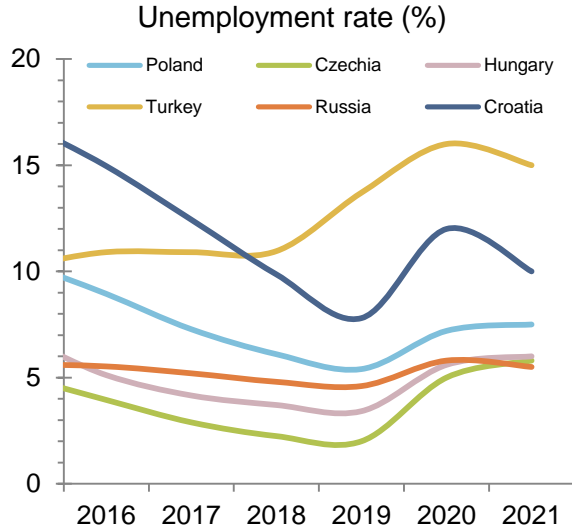
**CEE countries** do not have much room for interest rate cuts anymore.

**Poland, Croatia** and **Turkey** need monitoring with regard to government bond purchases by the CBs. M2 growth has already accelerated in these countries. Looking ahead, this could raise inflationary pressures in 2021-2022.

In **Hungary** and **Romania**, QE-like stimulus has been small so far.

Cyclical revenue weakness along with fiscal stimulus will widen fiscal deficits and increase public debt-to-GDP ratios. Yet, those ratios should remain in check, except for **Hungary**.

# EMERGING EUROPE: WITH EUROPE OR AGAINST IT?



Sources: National statistics, IMF, IHS, Allianz Research

Diverging paths depending on virus development and responsiveness to Europe's recovery and policy activism. Unemployment and inequality to rise in most vulnerable countries could cause social unrest

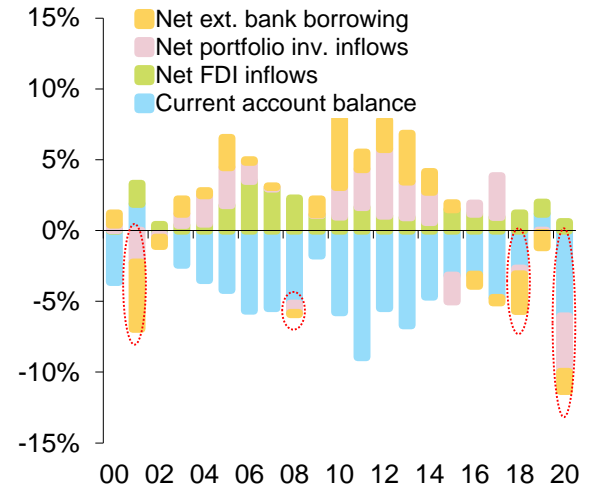
## Russia: Isolated in the long run?

**Potential new / intensified Western sanctions**, with firms linked to the Kremlin being the most likely targets, due to:

1. Alleged poisoning of Alexei Navalny (most prominent leader of Russia's independent opposition).
2. Involvement in Belarus crisis – events that resemble those that occurred in Ukraine in 2013-2014. Like then, Russia will not back down on its interests.

**Re-balancing of trade and investment flows to Russia away from Western countries towards China** will continue in the next years. Such a shift was already strong in the wake of the 2014 sanctions, softened a bit from 2018, but is likely to intensify again in the next years (also because of the China-U.S. tensions).

## Turkey: Continued BOP crisis



Sources: National statistics, IMF, Allianz Research estimates  
Soft FX controls already in place, but no excessive capital controls expected.

Instead the policy interest rate should eventually be hiked again by the end of 2020 to reign in the sliding TRY exchange rate.

# LATIN AMERICA: THE LAST SHALL BE FIRST AND THE FIRST LAST

Short-term recovery ranking

Ranking		Q3 Stringency	Export exposure to China and the U.S. (% GDP)	Daily activity index (Sept)	Phase 1 monetary and fiscal support
1	Brazil	Green	Orange	Green	Green
2	Mexico	Green	Green	Green	Red
3	Peru	Light Green	Yellow	White	Green
4	Chile	Orange	Light Green	Red	Green
5	Colombia	Orange	Orange	Yellow	Yellow
6	Argentina	Red	Red	Orange	Yellow

Medium-term recovery ranking

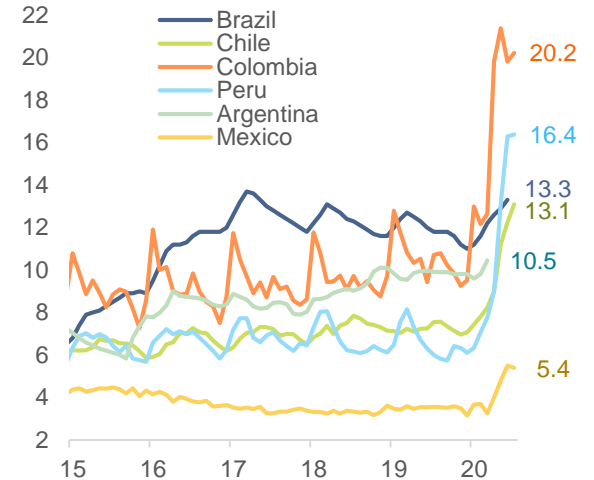
Ranking		Pre-Covid conditions (potential growth, debt, confidence)	Reform momentum	Debt sustainability	Social & political risk
1	Peru	Green	Yellow	Green	Green
3	Colombia	Yellow	Yellow	Yellow	Yellow
2	Chile	Yellow	Orange	Green	Orange
5	Argentina	Red	Yellow	Orange	Orange
5	Brazil	Orange	Yellow	Red	Orange
6	Mexico	Red	Red	Yellow	Yellow

Sources: National Statistics, Allianz Research

Sources: National Statistics, Allianz Research

Brazil and Mexico could exit the crisis the fastest but should struggle in the medium-term due to fundamentals. Better medium-term prospects for Chile, Peru, Colombia. Risks: (i) Big 2<sup>nd</sup> wave (lockdown more likely in Chile/Peru /Argentina/Colombia) (ii) political risk in Brazil (impeachment or gridlock); (iii) policy mistake in Mexico further deteriorating business environment

Unemployment rates (%)



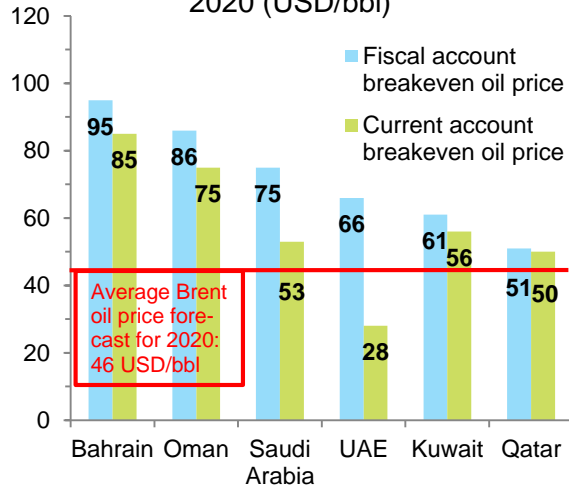
Sources: Macrobond, National Statistics, Allianz Research

Unemployment rates have shot up but still hide the parallel increase in inactive people (millions living on government support, without looking for a job)



# MIDDLE EAST: LOW OIL PRICES TO CREATE NEED FOR FISCAL REVENUES

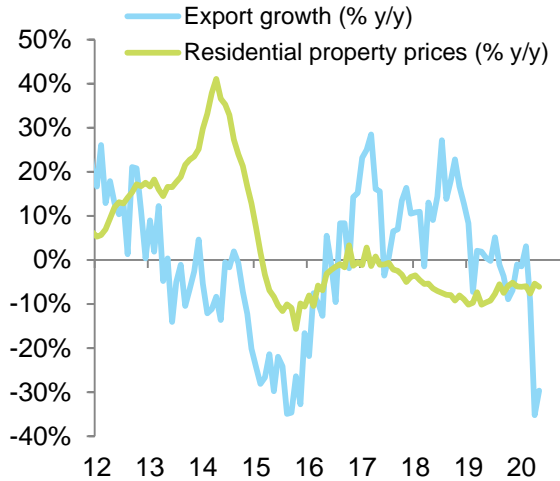
Fiscal and external breakeven oil prices 2020 (USD/bbl)



Sources: National statistics, IHS Markit, Allianz Research

Ongoing low oil prices (we forecast 51 USD/bbl in 2021) will cause continued large fiscal and current account deficits in the GCC. Bahrain's and Oman's buffers (SWFs and FX reserves are already exhausted).

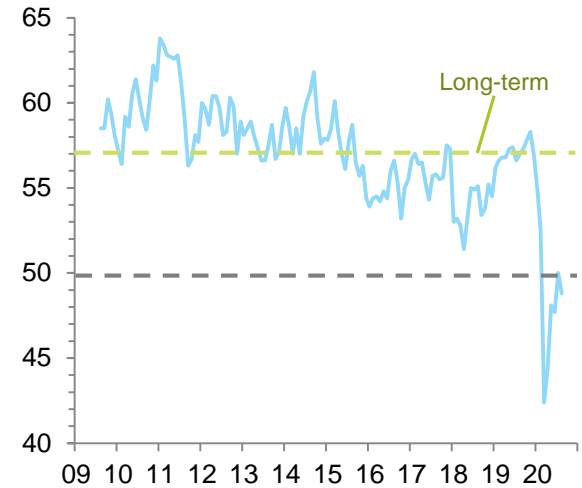
UAE: Multiple challenges



Sources: National statistics, Allianz Research

Property prices already -30% down from 2014 peak prior to Covid-19. Hence construction in recession, exacerbated by end of EXPO-2020-related works. Exports hit by low oil prices and slump in tourism (Covid-19, EXPO postponement).

Saudi Arabia: PMI non-oil private sector



Sources: IHS Markit, Allianz Research

The VAT increase from 5% to 15% from July 2020 will lead to a deterioration in business conditions (weaker consumer demand will jeopardize new business) and further slow the recovery.

# AFRICA: A CHINALESS RECOVERY IN 2021?

GDP growth (%)

	2019	2020	2021
<b>Africa</b>	<b>1.9</b>	<b>-4.3</b>	<b>3.4</b>
Commodity exports > 75%			
Angola	-0.5	-5.1	2.5
Algeria	1	-9.7	5.4
Nigeria	2	-5.3	2.5
Gabon	1.7	-1	3
Mozambique	-2	-1.2	5
Services exports > 35%			
Tunisia	1.2	-6.2	3.7
Namibia	-1	-1.5	2.5
Morocco	2.4	-5.2	4.5
South Africa	0.27	-8.2	2.7
Combined external and domestic shocks			
Cote d'Ivoire	7	-0.8	5.7
Kenya	5.4	-2.5	3.1
Ghana	6.5	-2.1	3.5
Egypt	5.6	-1.5	3.2

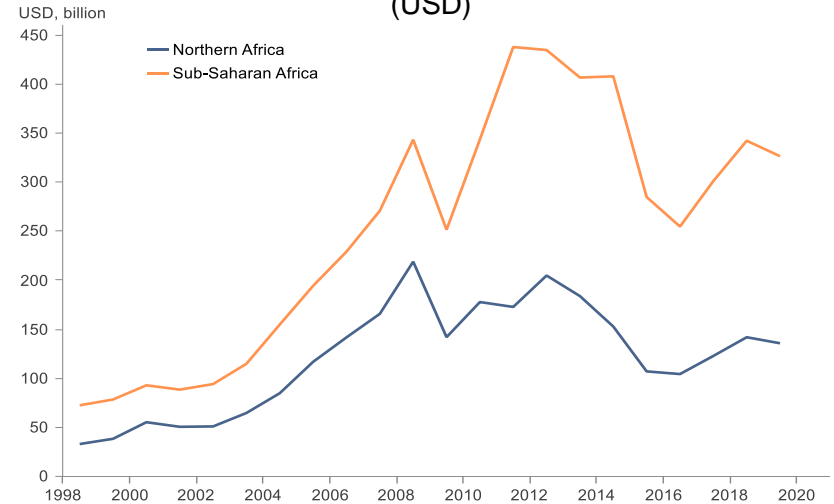
Sources: Allianz Research

## What is on the watch-list for 2021?

**Rising social risk in :** South Africa, Nigeria, Tunisia

**Financial stress in:** Kenya, Ghana, Zambia, Angola

Chinese merchandise imports from Africa (USD)



Sources: Allianz Research, Macrobond, Stats SA

Surging merchandise imports from China had helped to boost economic recovery after the GFC in 2009. We expect China to play a less active role to sustain the growth momentum after the Covid-19 crisis. South Africa is most at risk.

**APPENDIX**

**05**



# TOP 50 ECONOMIES – GDP FORECASTS



	2009	2019	2020f	2021f
United States	-2,5	2,3	-5,3	3,7
China	9,4	6,1	2,0	8,4
Japan	-5,4	0,7	-5,5	2,5
Germany	-5,6	0,6	-6,0	3,5
India	7,7	4,2	-7,2	6,5
The UK	-4,2	1,5	-11,8	2,5
France	-2,8	1,5	-9,8	6,9
Brazil	-0,1	1,1	-6,5	2,5
Italy	-5,3	0,3	-10,1	4,2
Canada	-2,9	1,7	-6,8	5,9
Russia	-7,9	1,3	-5,1	2,9
South Korea	0,8	2,0	-1,3	3,7
Australia	1,9	1,8	-4,1	3,4
Spain	-3,8	2,0	-11,8	6,4
Mexico	-5,1	-0,3	-10,0	2,0
Indonesia	4,7	5,0	-1,7	6,3
Turkey	-4,8	0,9	-4,7	4,0
Netherlands	-3,7	1,6	-4,5	3,1
Saudi Arabia	-2,1	0,3	-5,1	2,0
Switzerland	-2,2	0,9	-5,0	3,0
Argentina	-5,9	-2,1	-11,0	6,0
Sweden	-4,2	1,3	-4,5	3,0
Poland	2,7	4,1	-4,5	4,2
Belgium	-2,0	1,4	-7,8	4,1
Thailand	-0,7	2,4	-7,3	6,2

	2009	2019	2020f	2021f
Iran	0,9	-7,6	-15,0	3,0
Austria	-2,6	1,6	-7,0	4,0
Norway	-1,3	1,2	-5,5	4,0
The UAE	-5,2	1,7	-6,0	1,5
Nigeria	8,0	2,0	-5,3	2,5
Israel	1,0	3,3	-5,4	3,3
South Africa	-1,5	0,3	-8,2	2,7
Hong Kong	0,0	-1,2	-6,0	4,1
Ireland	-5,1	5,8	-5,0	4,0
Denmark	-4,9	2,4	-5,0	3,8
Singapore	0,1	0,7	-5,4	4,9
Malaysia	-1,6	4,3	-5,7	8,7
Colombia	1,1	3,3	-7,0	5,0
Philippines	1,5	6,1	-5,6	7,8
Pakistan	2,8	1,9	-2,4	2,1
Chile	-1,6	1,0	-6,1	3,4
Finland	-8,1	0,9	-4,0	2,0
Bangladesh	5,0	8,2	1,0	-2,7
Egypt	1,3	5,6	-1,5	3,2
Vietnam	0,0	7,1	3,1	6,9
Portugal	-3,1	2,2	-8,0	6,0
Czechia	-4,5	2,6	-7,1	5,3
Romania	-5,6	4,1	-6,4	4,2
Peru	1,1	2,2	-14,0	11,2
NZ	0,3	2,2	-4,8	4,2

# THANK YOU

Allianz Research

**Global Economic Outlook**  
*September 2020*



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