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Learning to live with the virus -

Economic and political outlook for 2H 2020

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Economics

Key themes

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The worst is over in the advanced world – as long as sufficient caution prevails to contain virus outbreaks

Three major assumptions

- No second wave of disruptive and widespread lockdowns, targeted and regional measures suffice to contain outbreaks
- Monetary, fiscal and regulatory policy makers remain in "whatever it takes" mode
- Trump does not start a major trade war this summer – the damage to US consumers could hurt him

Economic outlook

- Tick-shaped rebound in the advanced world
- Back to pre-pandemic GDP in early 2022 in the US, mid-2022 in the Eurozone and early 2023 in the UK
- Huge fiscal stimulus supports the US, Brexit holds back the UK
- No financial crisis, deflationary spiral or depression

The big risk

- US complacency backfires; widespread lockdowns in US disrupt recovery and shatter global confidence
- Conversely, a widely available vaccine or an effective treatment would boost confidence and improve demand trends

Politics

- Peak populism? A fast and calm response to the crisis pays off, phony populism does not
- Advantage Biden: Democratic sweep possible in US elections – but it is early days
- Europe muddles through as usual, deal on €750bn EU recovery fund likely

Virus trends: US at risk; Europe coping better

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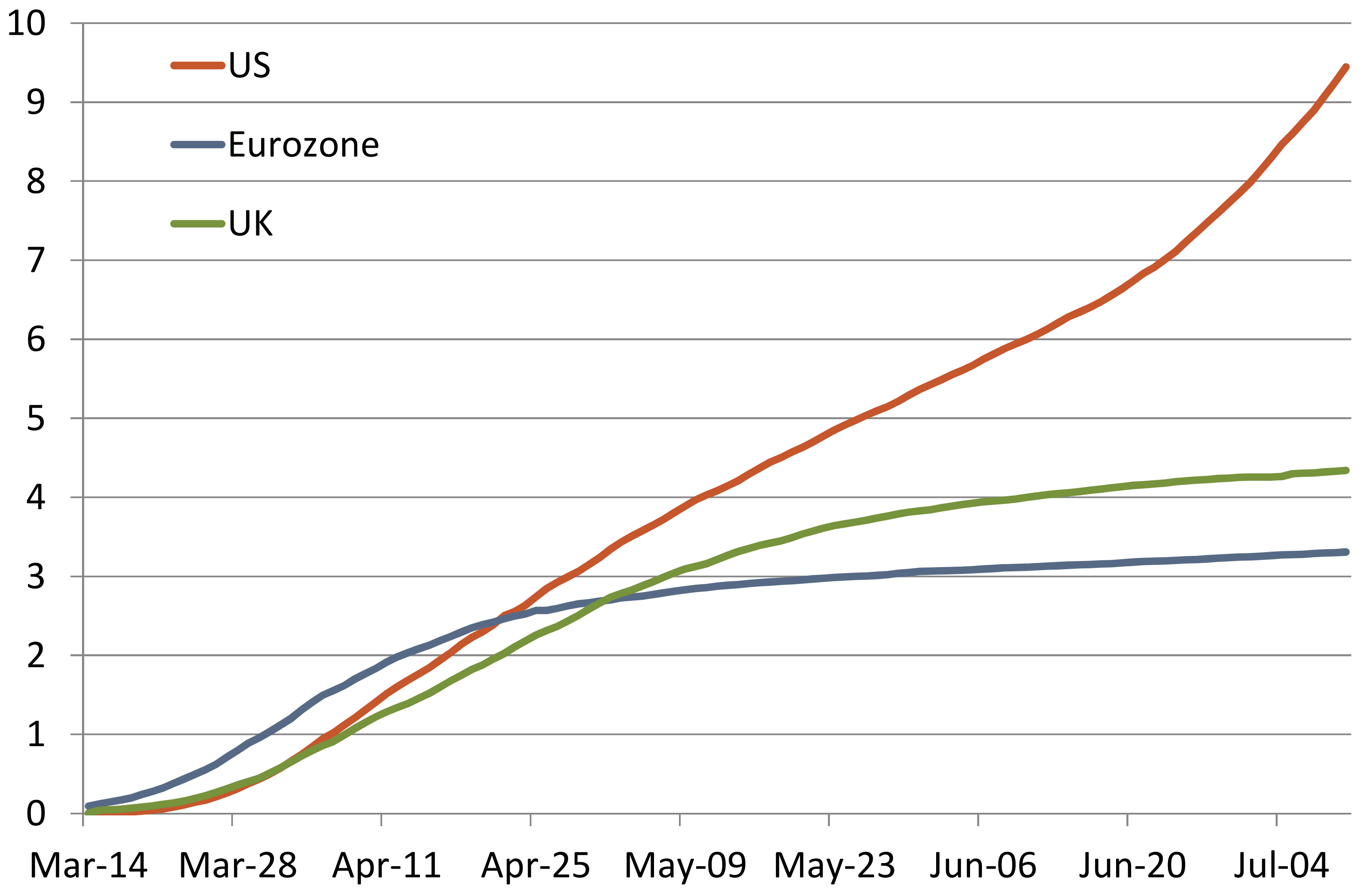
Confirmed cases per 1000 people



Source: Johns Hopkins University

- **Continental Europe:** infection rates are mostly stable at very low levels; targeted regional measures currently suffice to control new outbreaks.
- **UK:** having lagged far behind the Eurozone, the UK has finally managed to flatten the curve.
- **US:** daily new infections are rising rapidly after a premature easing of lockdowns. Some states are re-imposing restrictions.
- **Learning to live with the virus?** With more widespread testing and better knowledge about how to deal with Covid-19, the key question is: can medical capacities cope?
- **US virus trends are the top global risk to watch.**

The big risk: Covid-19 in the US

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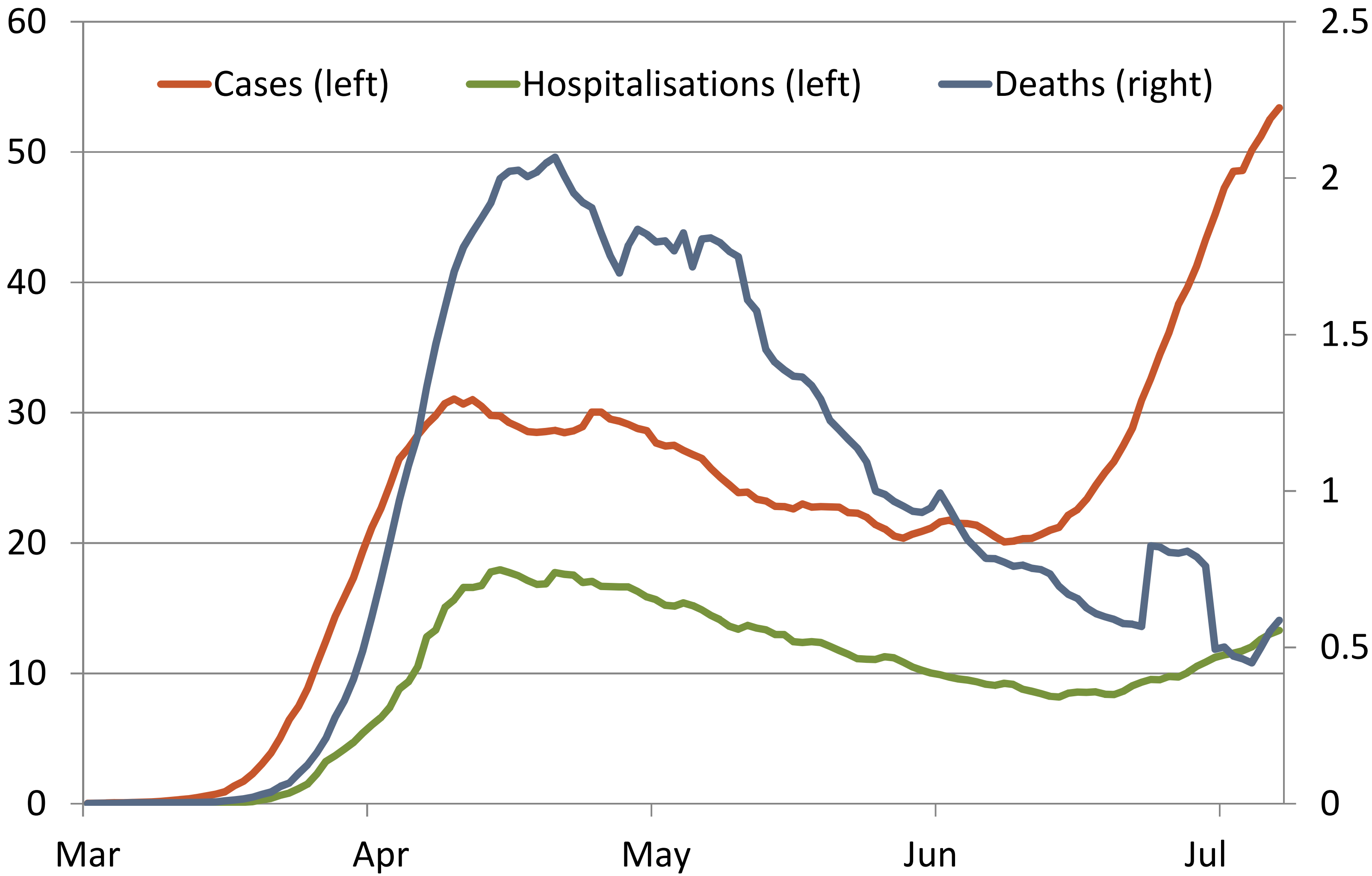
Huge surge in infections, hospitalisations up, deaths rising only a little – so far



Daily new cases and deaths 7-day rolling averages, in thousand. Current hospitalisations per 100,000 people. Source: Covid-19 Tracking Project

- **Mind the gap:** new infections are rising fast in in the US South and West.
- The number of people in hospitals has risen in the last four weeks.
- Expect some rise in the number of deaths soon.
- Our base case: selective and regional countermeasures and changes in behaviour will suffice to bring the rise in new infections under control … before medical capacities are so overstretched that much harsher, wider and disruptive measures will be required.
- **In limbo:** it will take weeks to see whether the new modest restrictions and changes in behaviour suffice to flatten the curve.

Covid-19 in the US: Going south and going west

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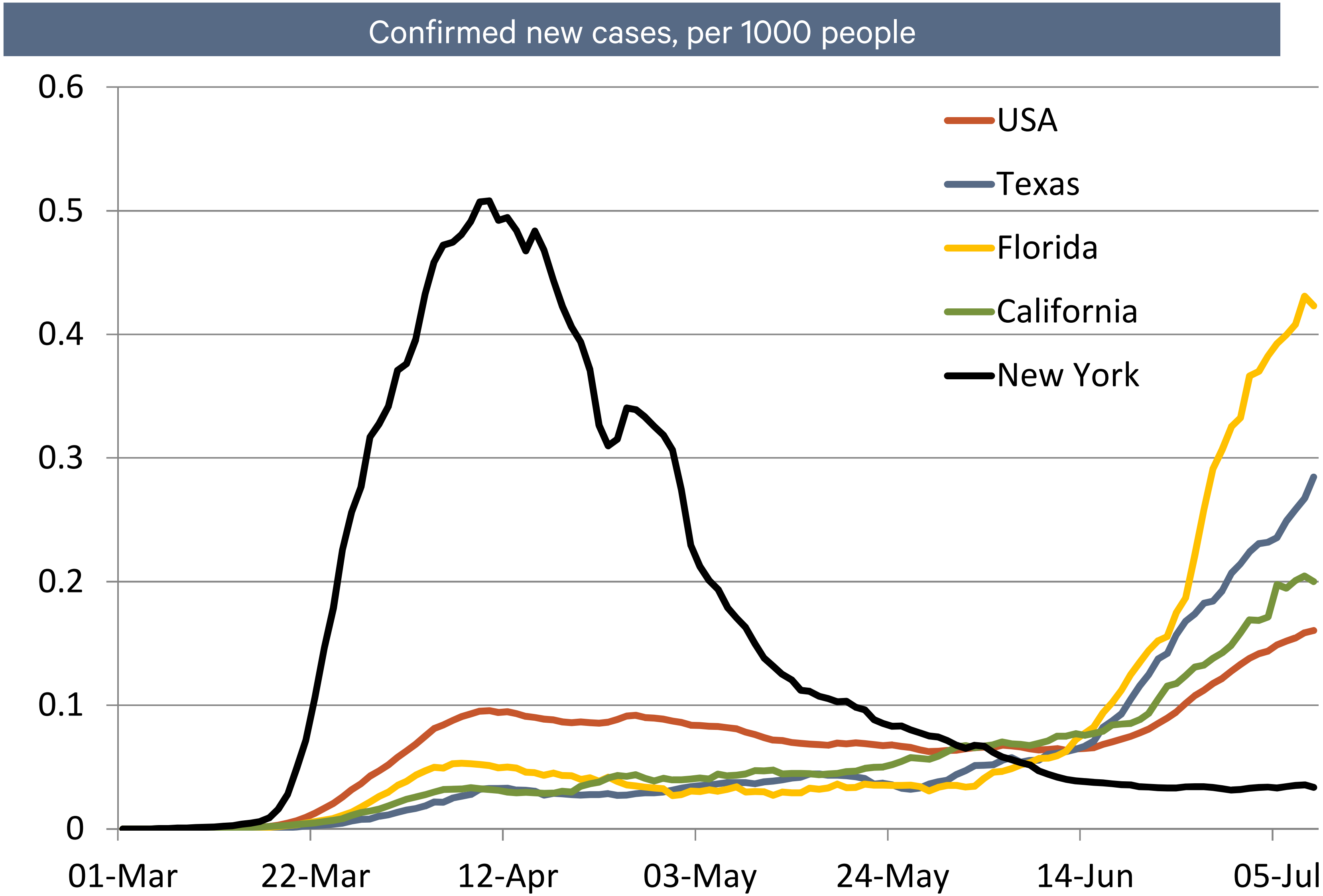

- New York brought the pandemic under control, much like Europe.
- Some other major states such as California, Texas, Florida and Arizona have not.
- The risk that the pandemic may worsen looms large as parts of the US have eased lockdown measures prematurely.
- Different political preferences: are parts of the US inclined to accept higher death rates per capita than most of Europe?

Confirmed new infections per day, seven-day moving averages, per 1000 people. Source: Github

After the virus: the tick-shaped recovery (1)

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The scale of the “sudden stop” recession is unprecedented in peace time – it will have some lasting effects

A severe and unusual emergency

The coronavirus pandemic and the lockdowns to contain it affect supply and demand in the various sectors of the economy in unusual and different ways. The impact ranges from sudden stops (long-distance travel) to significant losses (parts of manufacturing), to small losses (water and energy supply) and even to significant increases (online shopping). While harsh lockdowns last, output is 30% or more below normal for many countries.

Lessons from the past

As long as monetary, fiscal and regulatory policies remain in “whatever it takes” mode, the risk of second-round effects such as those of a follow-up financial crisis can be contained.

Past the worst of it

The recovery is under way. Major western economies started to lift economically significant restrictions from late April onwards. Having hit bottom in April, economic activity rebounded in May in most major economies. Many activities that had to be switched off are gradually switched on again step by step. Some activities such as long-distance travel will be restrained for much longer. Over time, the fiscal stimulus will partly offset some hesitation by consumers and companies to spend.

The tick mark recovery

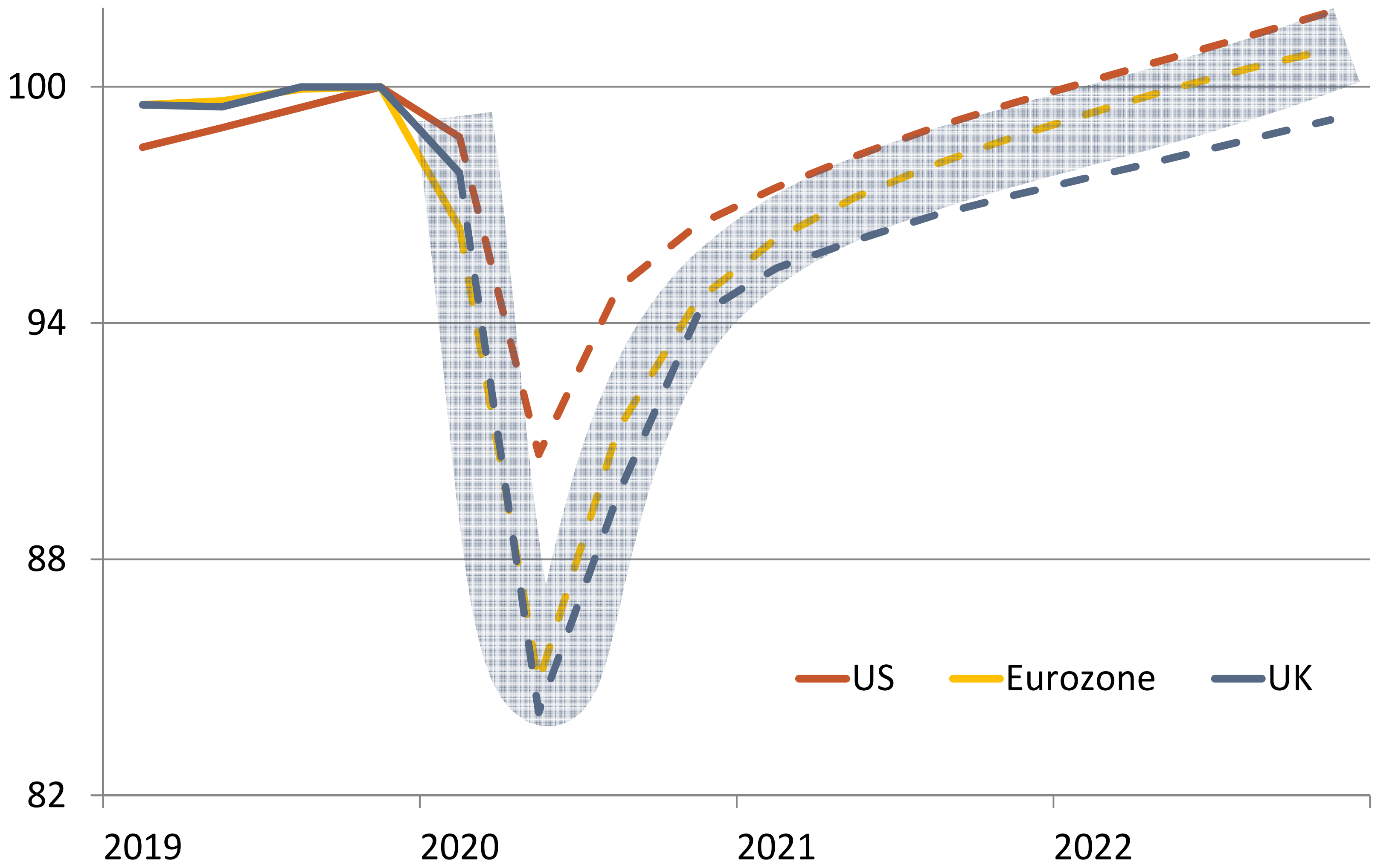
The shape of the rebound will depend on: i) the shape, depth and duration of the downturn, ii) the way in which lockdowns will be eased, iii) the reaction of demand to the easing of restrictions, and iv) the monetary and policy support.

We expect the sharp downturn of March and April to be follower by a strong but not-V-shaped initial rebound as supply is switched on again. The pace of recovery will flatten over time. We call this the “tick mark” recovery.

Activity can get back to its pre-pandemic level in early 2022 in the US (huge fiscal stimulus), in mid-2022 in the Eurozone (ex structurally weak Italy) and in early 2023 in the UK (Brexit damage).

After the virus: the tick-shaped recovery (2)

The tick-shaped recovery – real GDP (dotted lines show forecast)



Real GDP, Q4 2019 = 100. Quarterly data; Berenberg forecast from 2Q 2020 onwards. Source: Berenberg, Eurostat, ONS

- Q1 and Q2 2020: the worst peacetime slump, focussed on March (Q1) and April (Q2).
- As supply is switched on again, activity initially recovers fast.
- Helped by a base effect, Q3 should show a strong rebound in GDP relative to a Q2 depressed by a very weak April.
- GDP to surpass its late 2019 level in early 2022 in the US and in autumn 2022 in the Eurozone. Brexit makes for a shallower UK recovery.
- The US gets a boost from a very big fiscal stimulus, 17% of GDP deficit in 2020 vs. c12% for the UK/Eurozone.

Eurozone: enough money to finance a rebound

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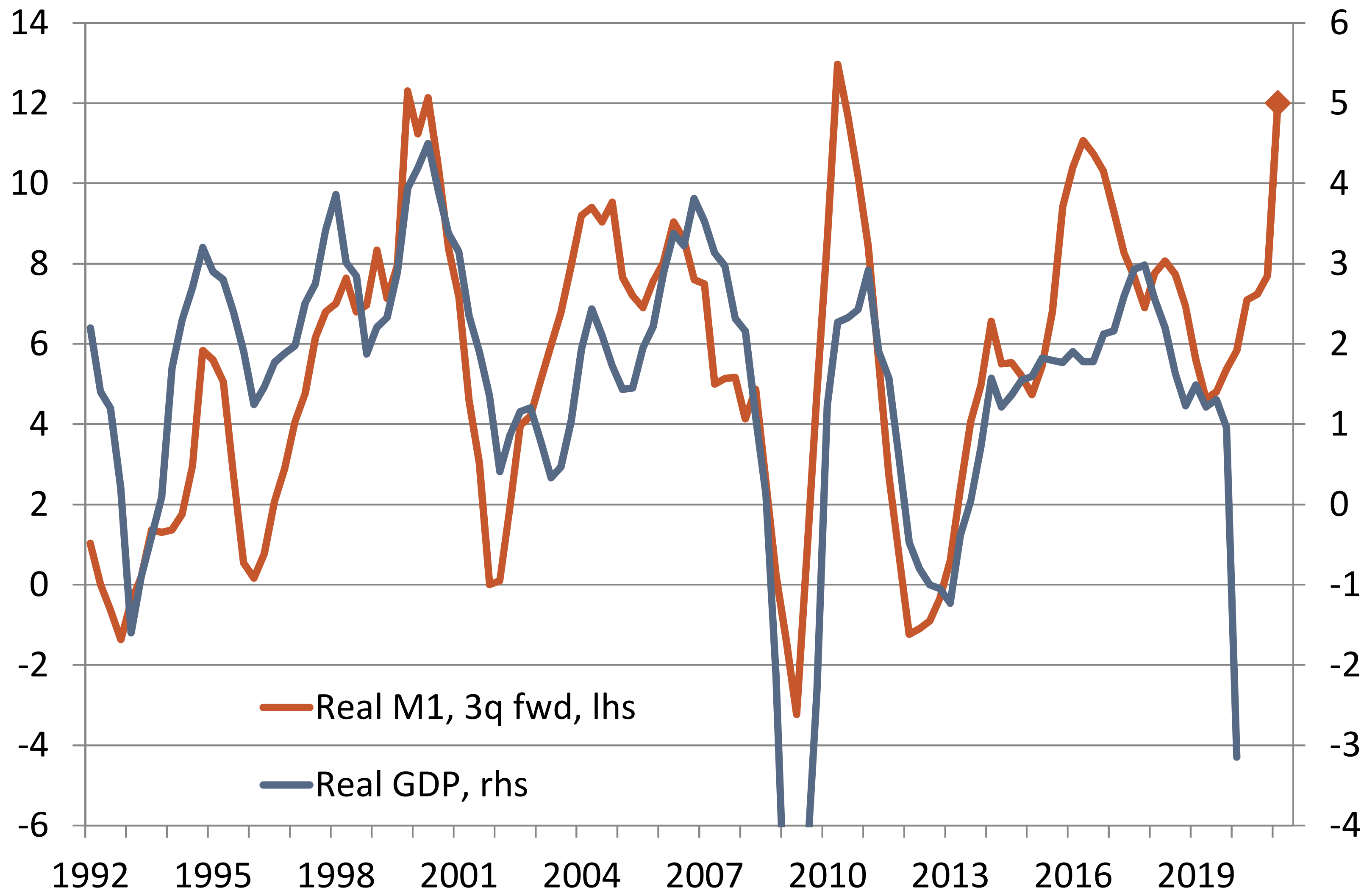
Money matters: Eurozone real M1 money supply and real GDP

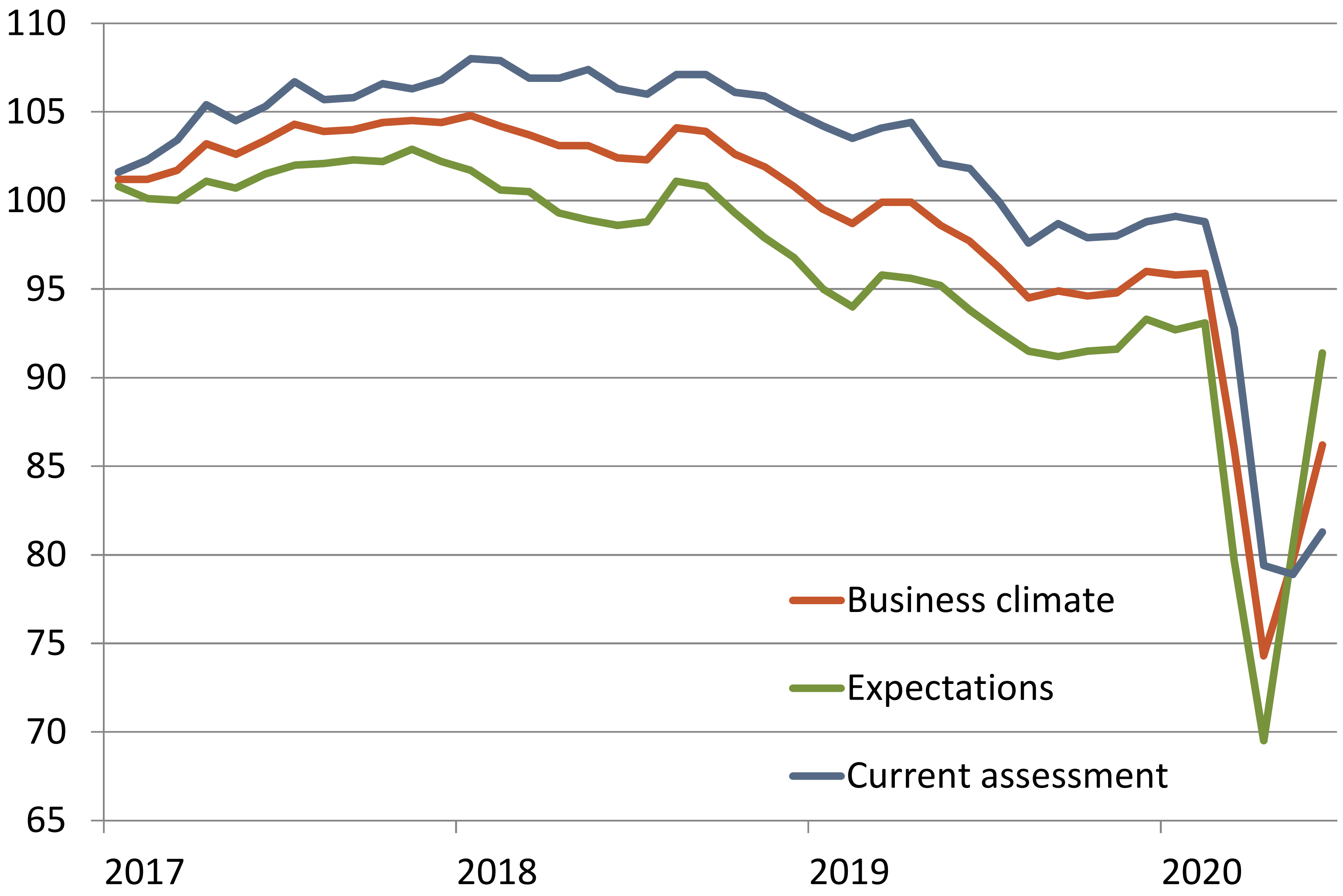


Real M1 money supply, deflated by consumer prices, advanced by 3 quarters, left-hand scale; real GDP, right-hand scale, yoy changes in %. Sources: ECB, Eurostat, Berenberg

- Have money, will spend. In the bank-based financial system of the Eurozone, M1 money supply is usually a leading indicator of real GDP growth.
- The transmission mechanism: the central bank makes it easy for households and companies to hoard more liquidity. When the risks that caused the demand for precautionary cash start to fade, households and companies spend some of the surplus cash.
- Unusual times: real M1 growth has surged in response to the crisis while activity has plunged during the lockdowns.
- Especially companies are hoarding cash, having drawn down credit lines.

Surge in expectations heralds economic rebound

German Ifo business climate survey: beyond the plunge



Indexed at 2015=100. Source: Ifo, Berenberg

- Germany's Ifo business climate index rose to 86.2 in June from 79.5 in May and its historic low of 74.2 in April.
- Expectations, which had started to recover already in May, jumped further in June (from 80.1 to 91.4).
- Businesses' assessment of current conditions improved for the first time in five months. In June
- Expectations usually lead activity. In the absence of a new virus shock, activity will rebound significantly in the next few months.
- High-frequency indicators, also point to a significant rebound in activity as production facilities are being switched on again.

Green shoots of growth in high frequency data (1)

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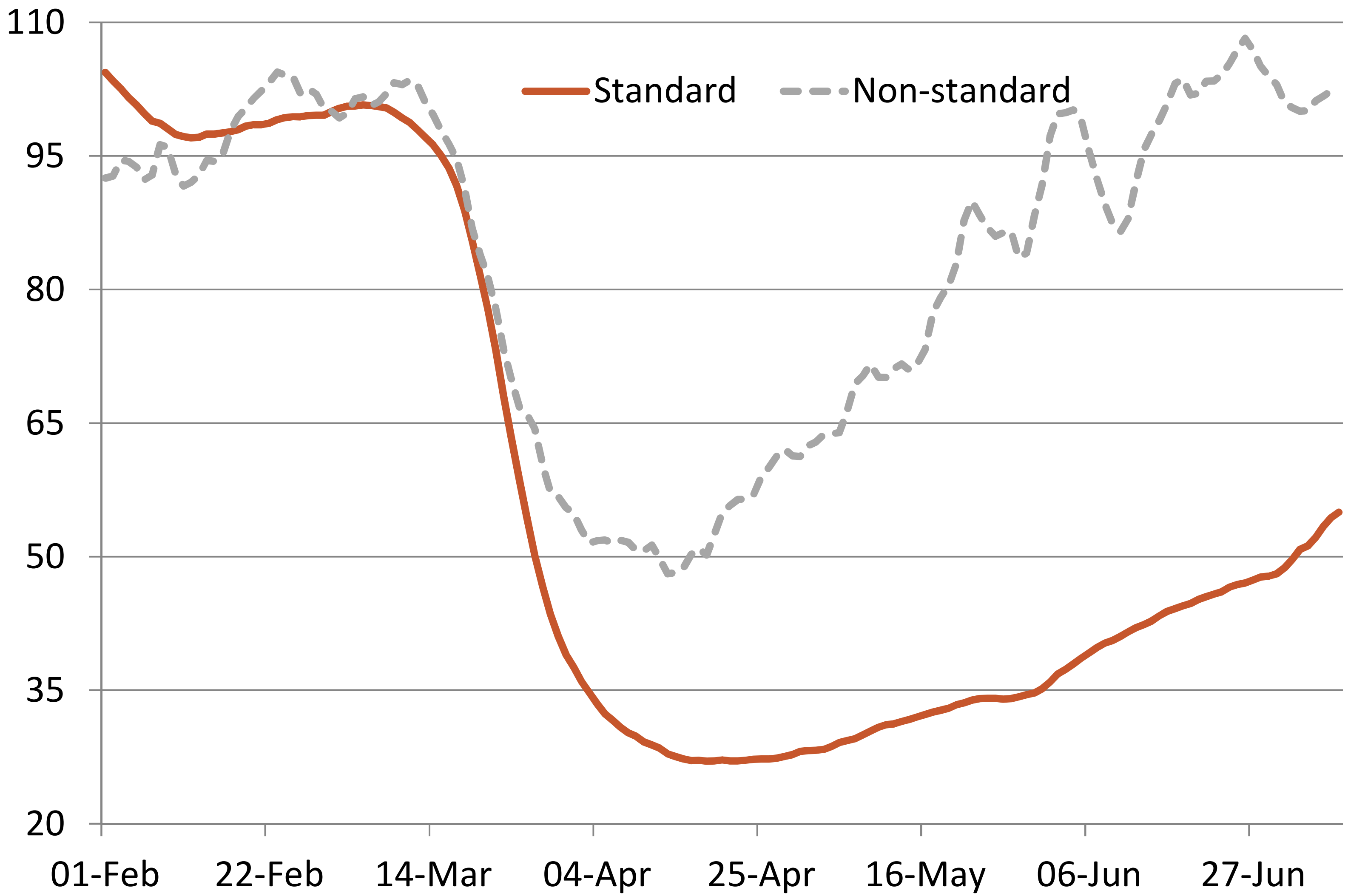
Global flights per day (000s, 7 day moving average)

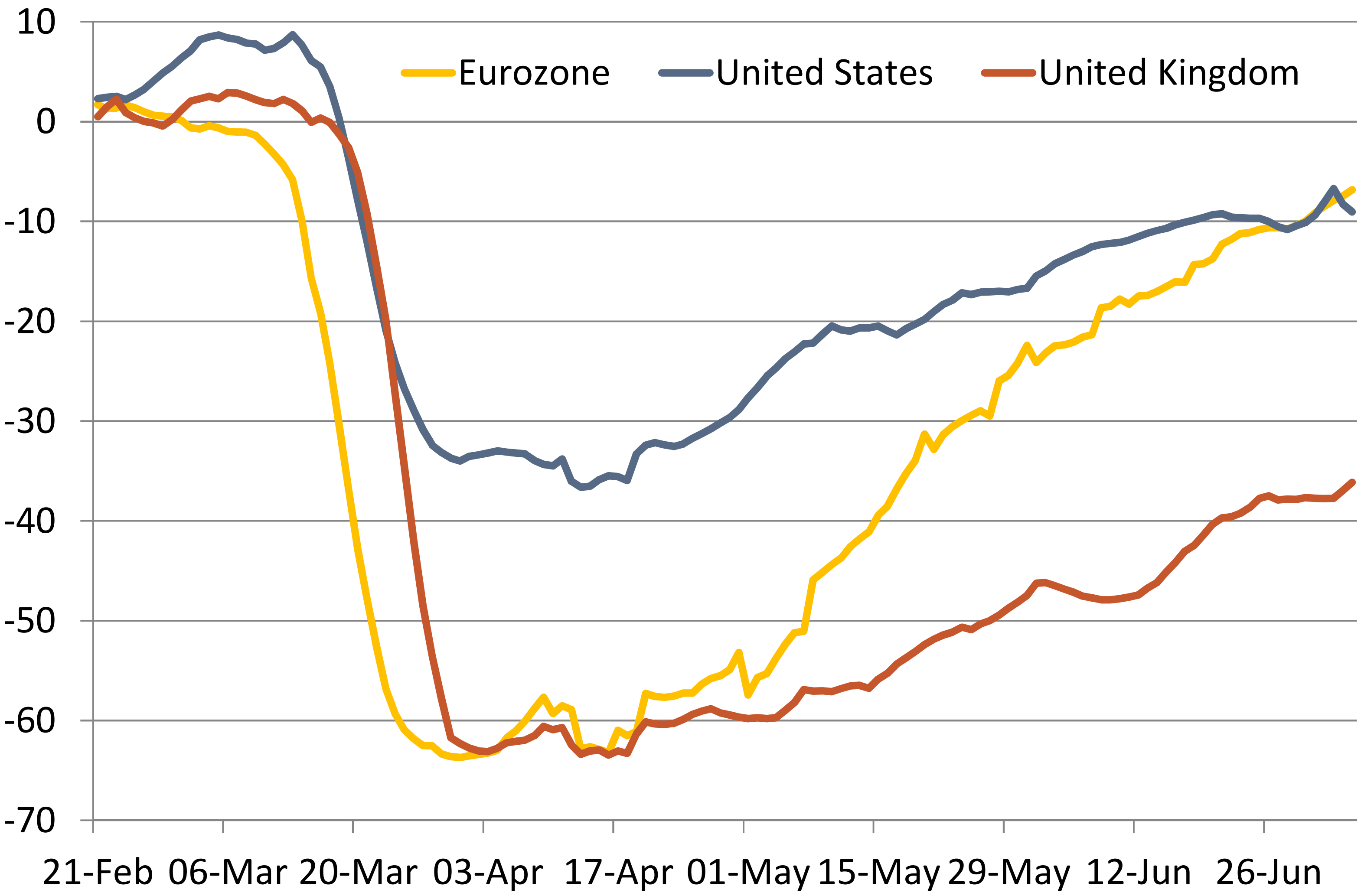


Indexed to 100 at March 1 2020. Standard flights include commercial passenger flights, cargo flights, charter flights and some business jet flights. Non-standard flights include private flights, most helicopter flights, most ambulance flights, government flights, some military flights, drones and gliders. Source: Flightradar24

- Despite continued travel restrictions, global flight data suggests standard flights including commercial passenger flights, cargo flights and charter flights have more than doubled since their low in mid April, but remain 45% below the pre-crisis level
- Country level data show increases in China coal consumption, US motor gasoline supplies, US business applications, UK port traffic and UK job vacancies

Green shoots of growth in high frequency data (2)

Retail footfall for advanced economies (% from baseline)



Daily data. Seven day moving average. Values are the percentage change compared to the baseline, which is the median value from the 5-week period Jan 3 - Feb 6, 2020 for the same day of the week. Weighted footfall changes for Retail & Recreation and Grocery & Pharmacy 2:1. Source: Google

- How many people are going to the shops?
- Google data on retail footfall show a broad-based improvement versus the mid-April lows.
- Relative to the pre-COVID period from 3 January to 6 February, Eurozone footfall in the week up to 5 July was just 7% below normal versus c60% in mid-April.
- In the US, the recovery in the footfall has stalled for the past three weeks at around 10% below normal (up from a -35% low in mid-April).
- Footfall may fall in the US for a while if the pandemic worsens.

Europe: The consumer rebound has started

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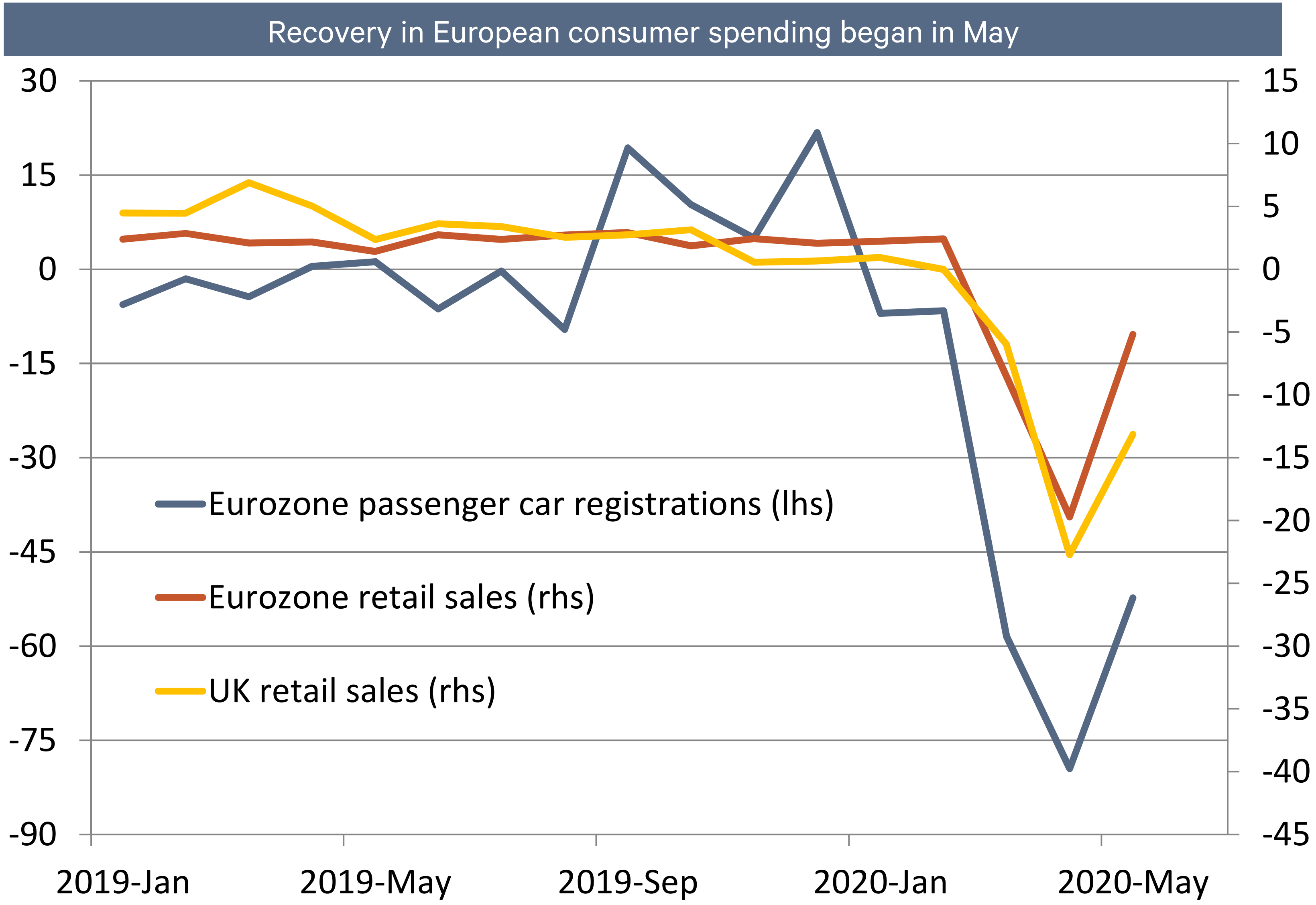
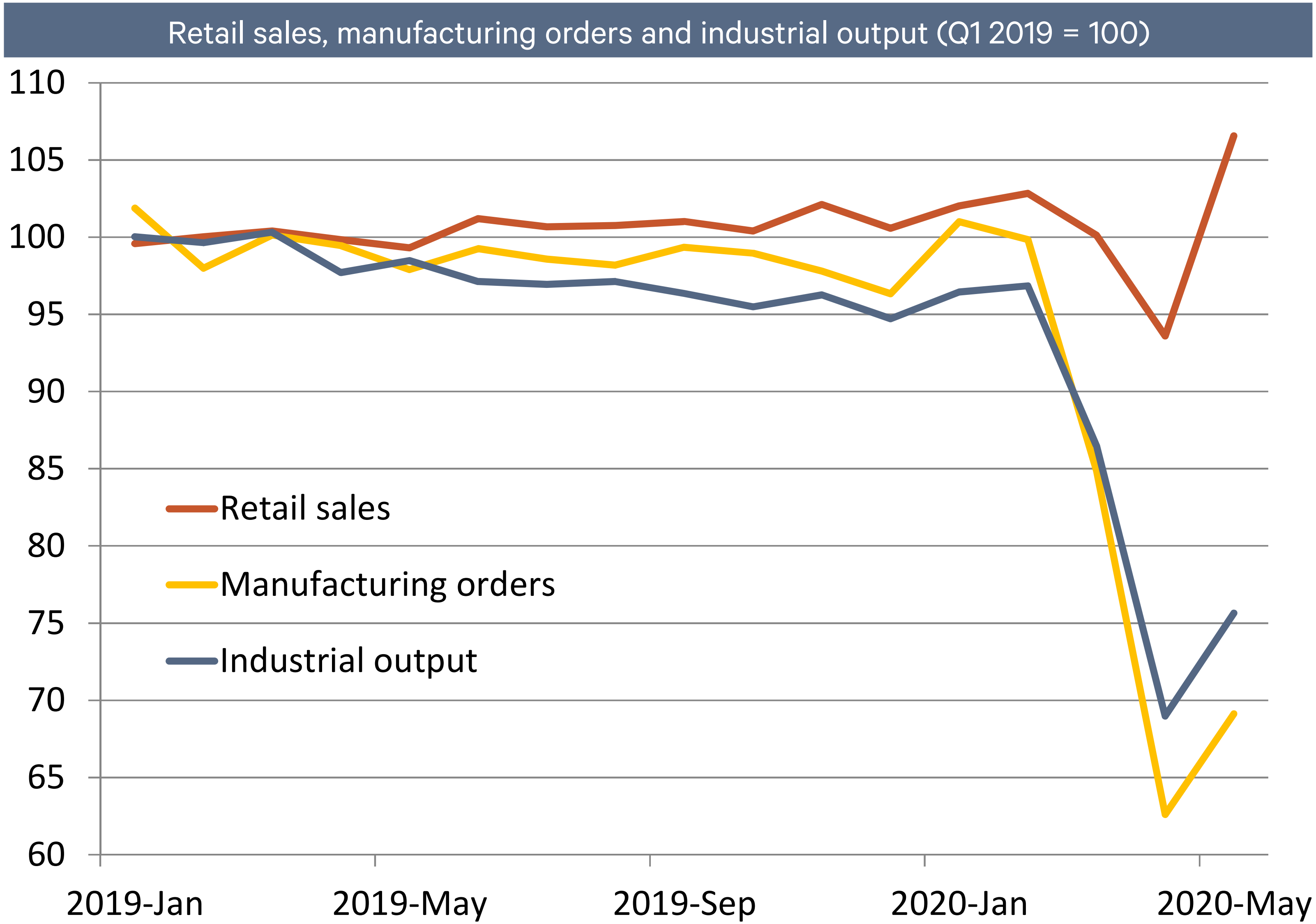


Yoy changes in %; monthly data. Source Eurostat ONS. Association des Constructeurs Européens d'Autos.

- With the easing of lockdowns in May, households have started to open their wallets again.
- While spending remains well below normal, Eurozone car registrations, Eurozone and UK retail sales surged in May.
- Helped by generous fiscal and monetary support, demand will likely recover further.
- Even the UK uptick is impressive as most non-essential stores were closed throughout May – the rise was driven by a surge in non-store retailing.

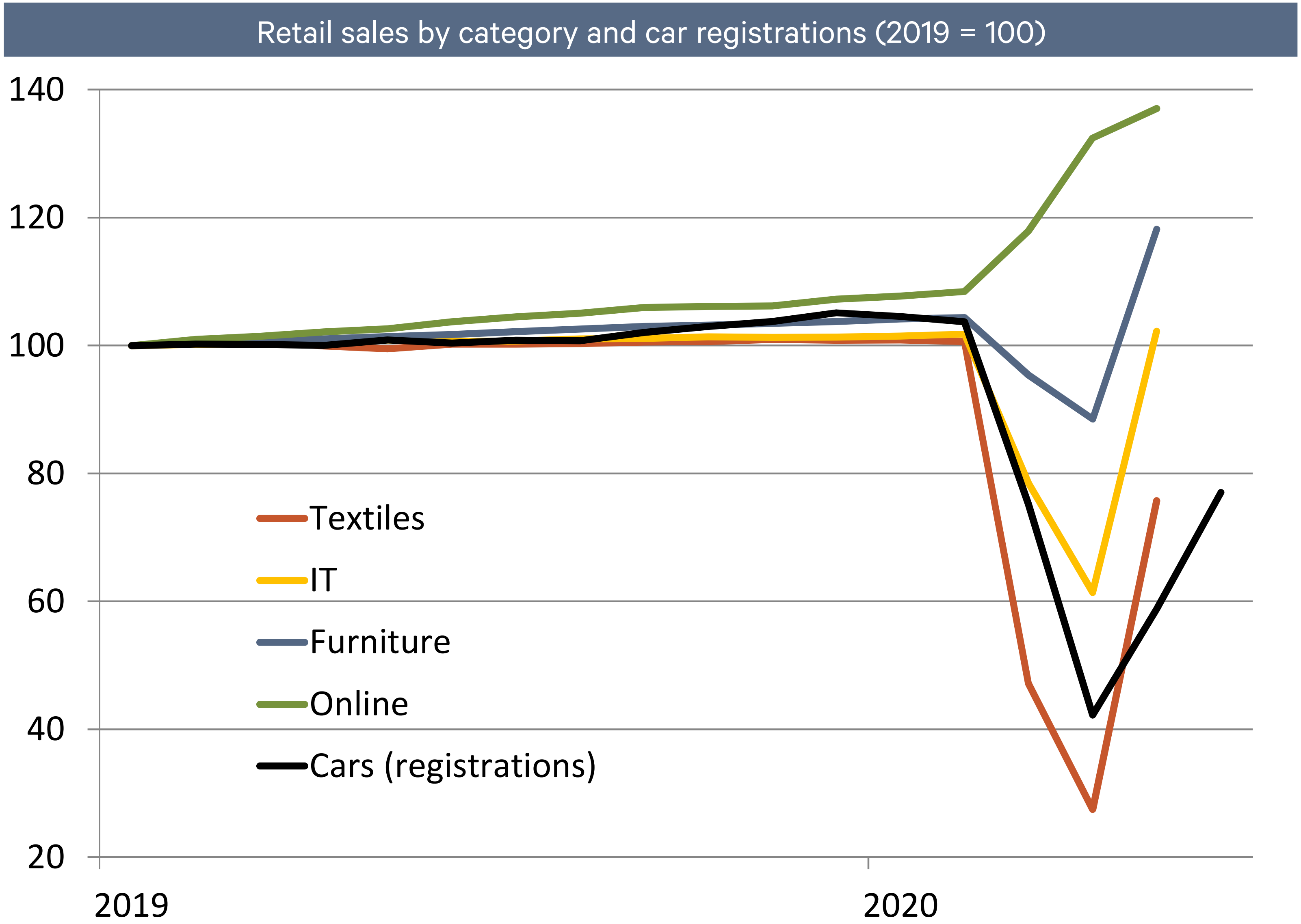
Germany: the unbalanced rebound



Q1 2019 = 100. Monthly data. Source: Destatis, BMWi.

- The German approach to the pandemic with early lockdowns, calm communications and significant fiscal support seems to be paying off
- German consumers opened their wallets like never before in May. The data seems almost too good to be true, though. Other data such as footfall in shopping areas point to a major rebound but not to record sales.
- Industry and exports are lagging behind.
- Despite the first monthly double-digit increase, manufacturing orders remained some 30% below their Q1 level in May.

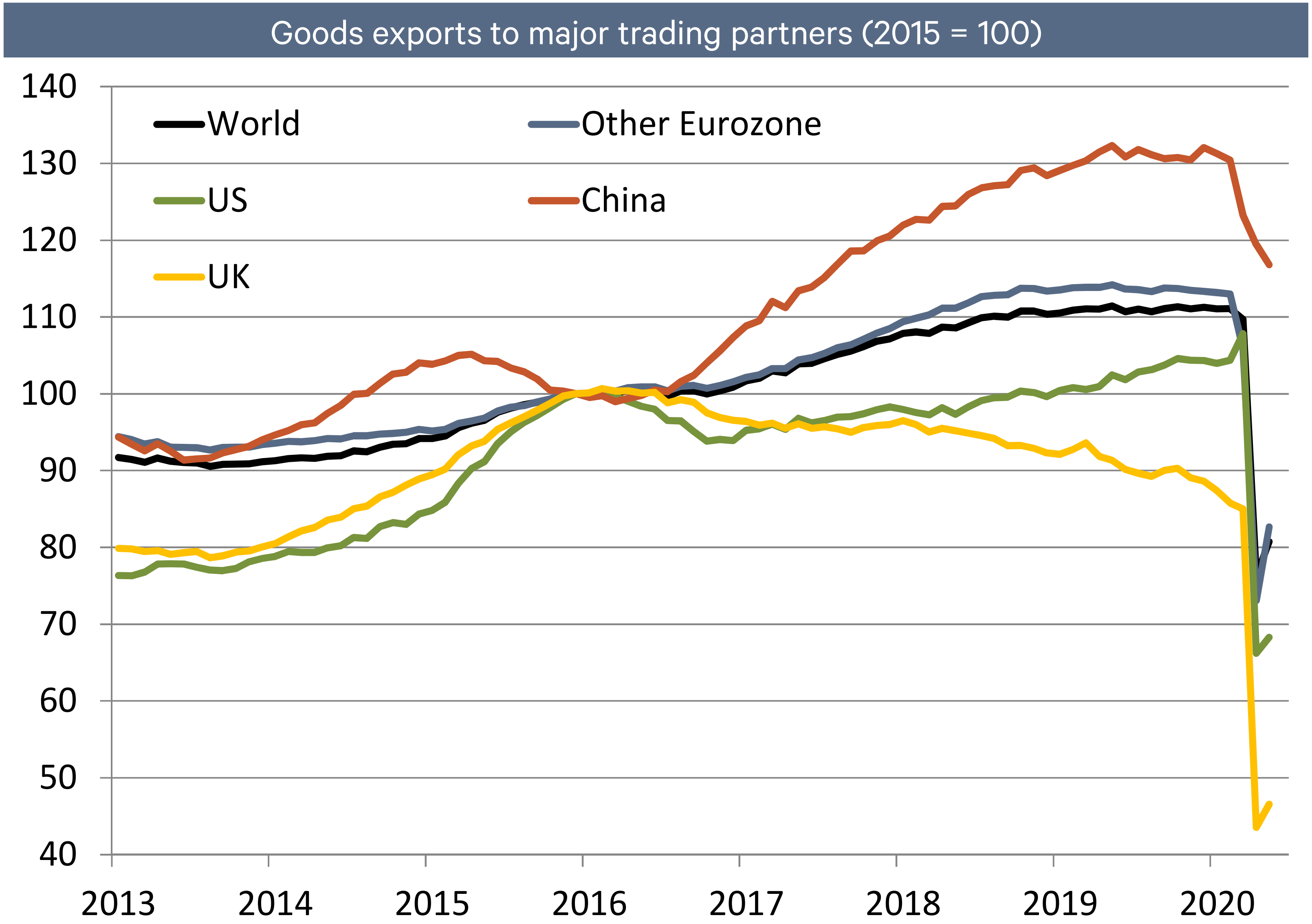
The rebound starts at a home – the German example



2015 = 100. 12-month rolling average up to February 2020. Actual values from March 2020 onwards Source: Destatis, Bundesbank, Kraftfahrtbundesamt.

- During the lockdowns in March/April, people spent more time at home. Internet sales surged.
- Once the shops opened and people dared to go out again, they took care of their homes: sales of home improvement items, furniture, and technical gadgets for home entertainment and digital access surged in May.
- Textile and car sales are also rebounding, but from a much lower level.
- Expect the boom in home improvement to fade – while normal sales will likely recover further.
- Lingering caution can keep car sales below normal.

German exports: where is the problem?

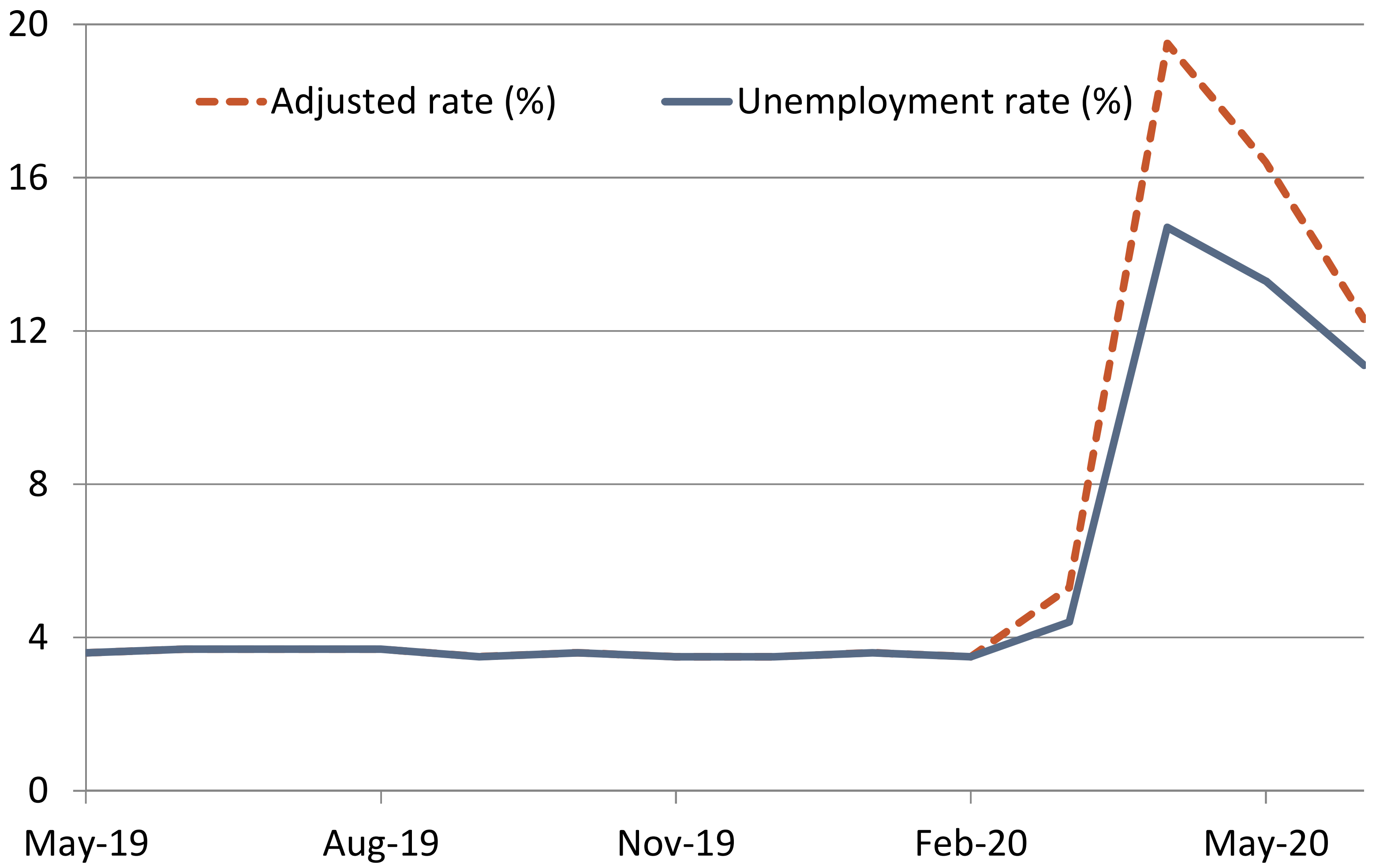


German goods exports, nominal, 12month rolling averages except for April/May 2020, rebased to 2015 average = 100. Data for China include Hong Kong. Source: Destatis

- Global trade plunged when the virus hit Europe and the US in March.
- While German exports to China fell only modestly as China began to ease restrictions early…
- …exports to other countries fell sharply in April.
- **The rebound starts close to home:** German exports to its neighbours in the Eurozone rebounded in May…
- …whereas sales to the UK (late easing of lockdowns) and the far-away US barely recovered.
- Expect exports to lag behind domestic demand.
- Shares in German goods exports for major regions: Eurozone 37%, US 9%, UK 6%, China 7%.

US labour market: beyond the worst

US: reported and adjusted unemployment rate, in %

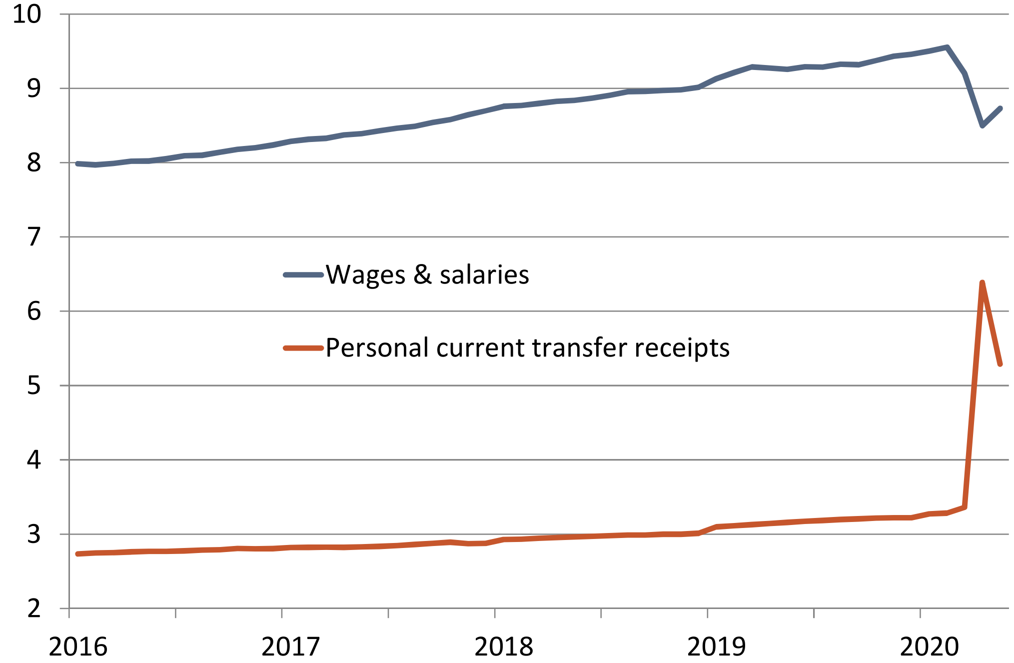


- After a major surge in March and April, unemployment fell in May and June.
- The data have to be treated with great caution as the survey cannot be conducted as normal in times of lockdowns.
- The adjusted rate includes BLS estimates for the number of respondents who have misclassified their situation in the survey as employed instead of “on temporary layoff”.

Source: Bureau of Labor Statistics/Haver Analytics. The adjusted unemployment rate, unemployment and employment series are adjusted by Haver Analytics using the non seasonally adjusted BLS estimates of workers on temporary layoff who were misclassified as employed but not at work

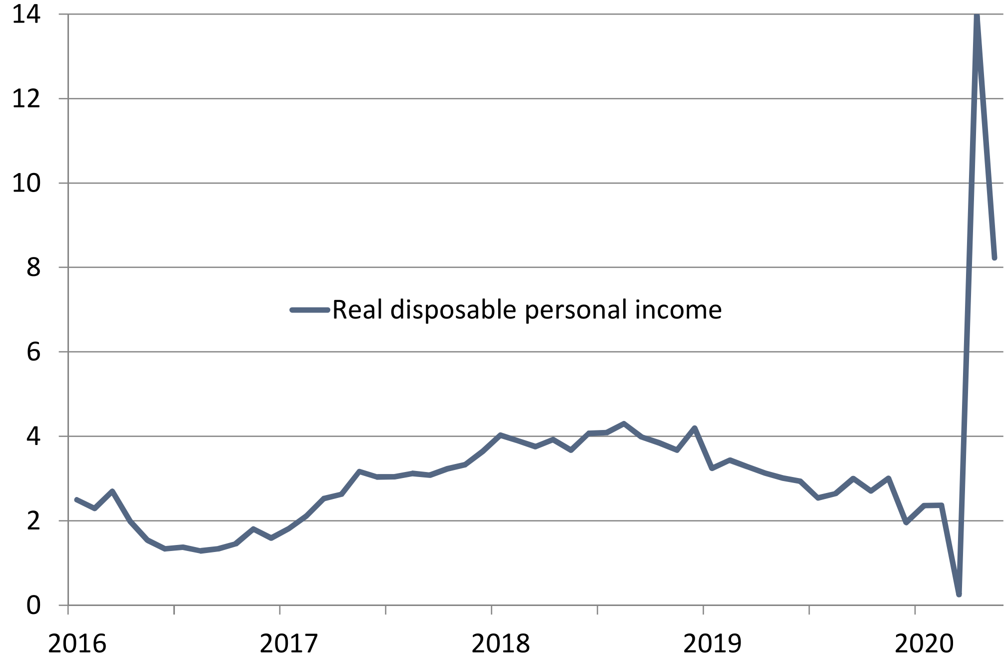
US: Wage income down, disposable income up

Wages down, transfers up



SAAR. In trillion US dollar. Monthly data. Source: BEA

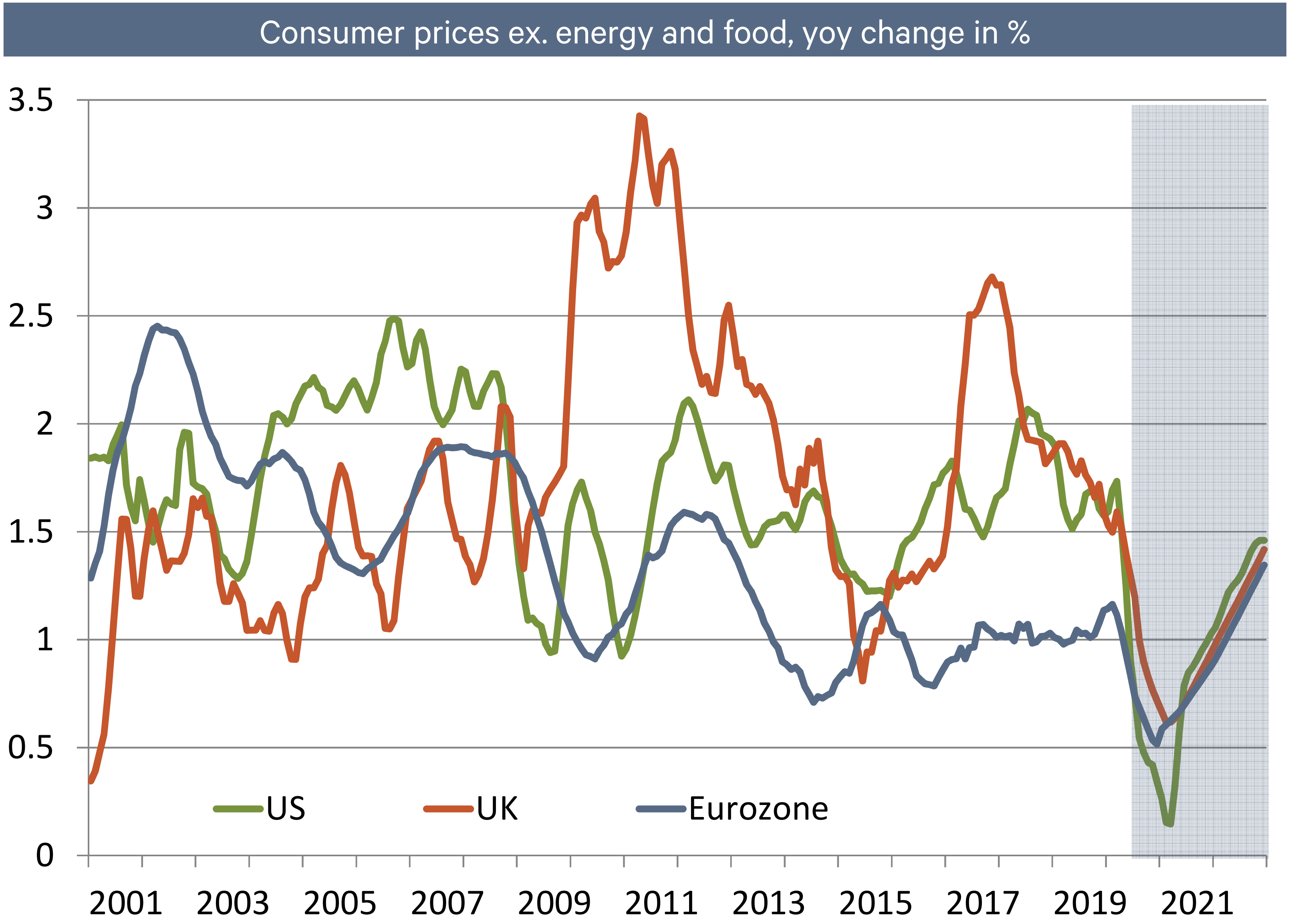
Rise in transfers more than offsets wage shortfall



Yoy change in %. Monthly data. Source: BEA

- A cheque in the mail: Generous income support of up to $1200 per adult and support for unemployed workers boosted US personal incomes in April and May…
- …despite a drop in wage and salary incomes.
- The April spike reversed only modestly in May.

Subdued: core inflation in the developed world



Consumer prices excluding energy and food (PCE for US), yoy change in %, 3-month moving averages.
Sources: BLS, ONS, Eurostat, Berenberg calculations

- Core inflation remains under control in the developed world.
- The pandemic has caused a simultaneous plunge in supply and demand.
- As the lockdowns are eased, the rebound in demand will lag behind the switching on of supply.
- Scared by the crisis, households and companies will spend and invest more cautiously than before.
- As a result, core inflation is likely to recede further.
- Elevated unemployment will add to downward pressure.
- But the world is not heading for dangerous deflation.
- Some VAT cuts in Europe will push core inflation down temporarily further in 2H 2020.

Global politics: a sobering shock?

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A watershed event – a mega-crisis can shape political debates and choices for a long time to come

The worst peacetime recession: Crises of such a scale can make or break leaders.

Peak populism? The pandemic is taking a particularly heavy toll on countries whose overconfident leaders trusted their own political instincts more than sound advice, at least initially. Some countries with a calmer and more science-based response are faring better. This may make it more difficult for populists to peddle their fact-defying slogans.

Or more unrest? The costs of the recession fall heavily on less skilled service workers and new entrants to the labour market. This may fuel discontent.

A leaderless world: All of the major global players, the US, China and the European Union, got their initial response to the crisis partly wrong. An even more fragmented world could be a more dangerous place, especially if the US continues to weaken global institutions, as well as its own soft power. But if the US returns to a more co-operative foreign policy, the world may benefit.

Advantage Biden? In the US, President Donald Trump is no longer the favourite to win the election on 3 November. If Joe Biden makes it into the White House instead, he may pursue a more centre-left policy agenda as the Democrats would have a good chance to win a majority in both houses of Congress. More domestic regulation may sour the economic mood in the US. A calmer foreign and trade policy would still come as a relief to other parts of the world. Almost four months ahead of the US election, it is still very early days.

Risks to the cohesion of Europe: With a belated decision to promote a generous €750bn recovery fund, Germany may be helping to rein in the surge in anti-EU sentiment in parts of southern Europe. However, the future cohesion of the EU looks a little less secure now as the initial impression of insufficient solidarity in the critical months of March and April may linger.

Politics: early and calm approach to the virus pays off

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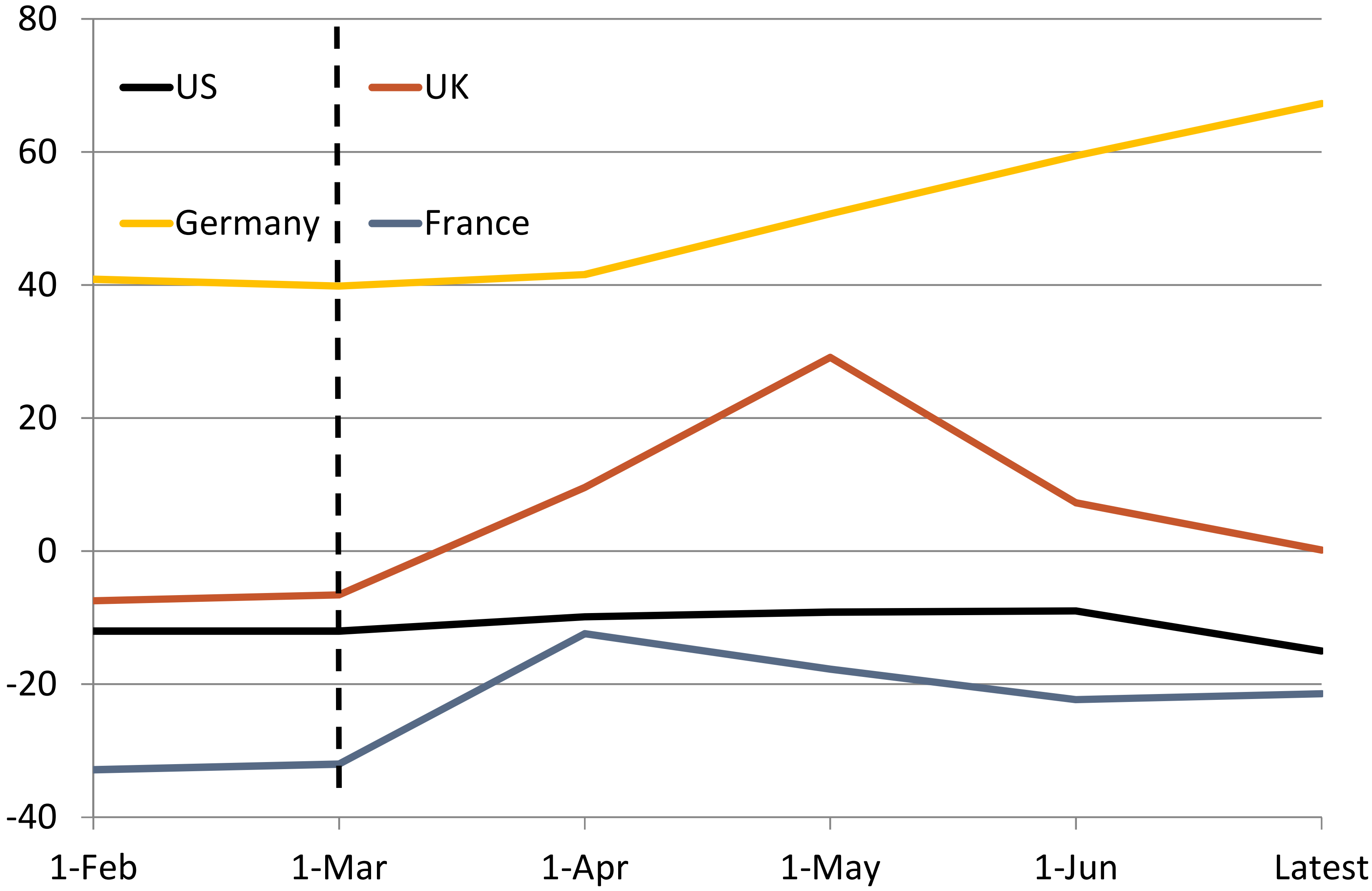
Merkel ahead, Trump flagging: net approval of top political leaders



Balance of approve and disapprove, in percentage points. Vertical line denotes major spread of pandemic in Europe. Source: National opinion polls, Wikipedia, Berenberg

- In a crisis that is seen as an external shock, nations often rally around their leaders.
- This happened in many advanced countries in March and/or April.
- But since then, fortunes have diverged.
- Germany's Angela Merkel remains popular while US president Trump and UK prime Minister Johnson have lost support.
- Incidents not related to their initial tepid response to the virus have added to that (the Dominic Cummings affair in the UK, Trump's reaction to recent protests in the US).

US politics: A Democratic sweep?

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Advantage Biden – but it is early days

The US will hold presidential elections on 3 November. All 435 seats in the House of Representatives and 35 out of the 100 seats in the Senate are also up for election. The Democrats currently control the House, the Republicans have 53 seats in the Senate. In the Senate, 23 Republican-held and 12 Democratic-held will be contested.

Two key issues: (i) who will be president, and (ii) will Congress remain divided = gridlock ?

Three mainstream scenarios

- **Joe Biden wins the White House, Democrats win the Senate**
  = Significant tilt in domestic policies to the left, less erratic foreign and trade policy

- **Joe Biden wins the White House, Congress remains divided**
  = No major change in legislation, some domestic re-regulation, less erratic foreign and trade policy

- **Trump is re-elected, Congress remains divided**
  = More of the same, some domestic deregulation, foreign and trade policy uncertainty continue

One tail-risk scenario – unlikely but not fully impossible

- **Trump is re-elected, Republicans win firm control of both houses of Congress**
  = Trump unbound, major spending increases and tax cuts; foreign and trade policy remains erratic
  = boom–bust in markets and economy: major fiscal stimulus first, but Fed forced to tighten earlier than otherwise

US elections: Biden has the edge

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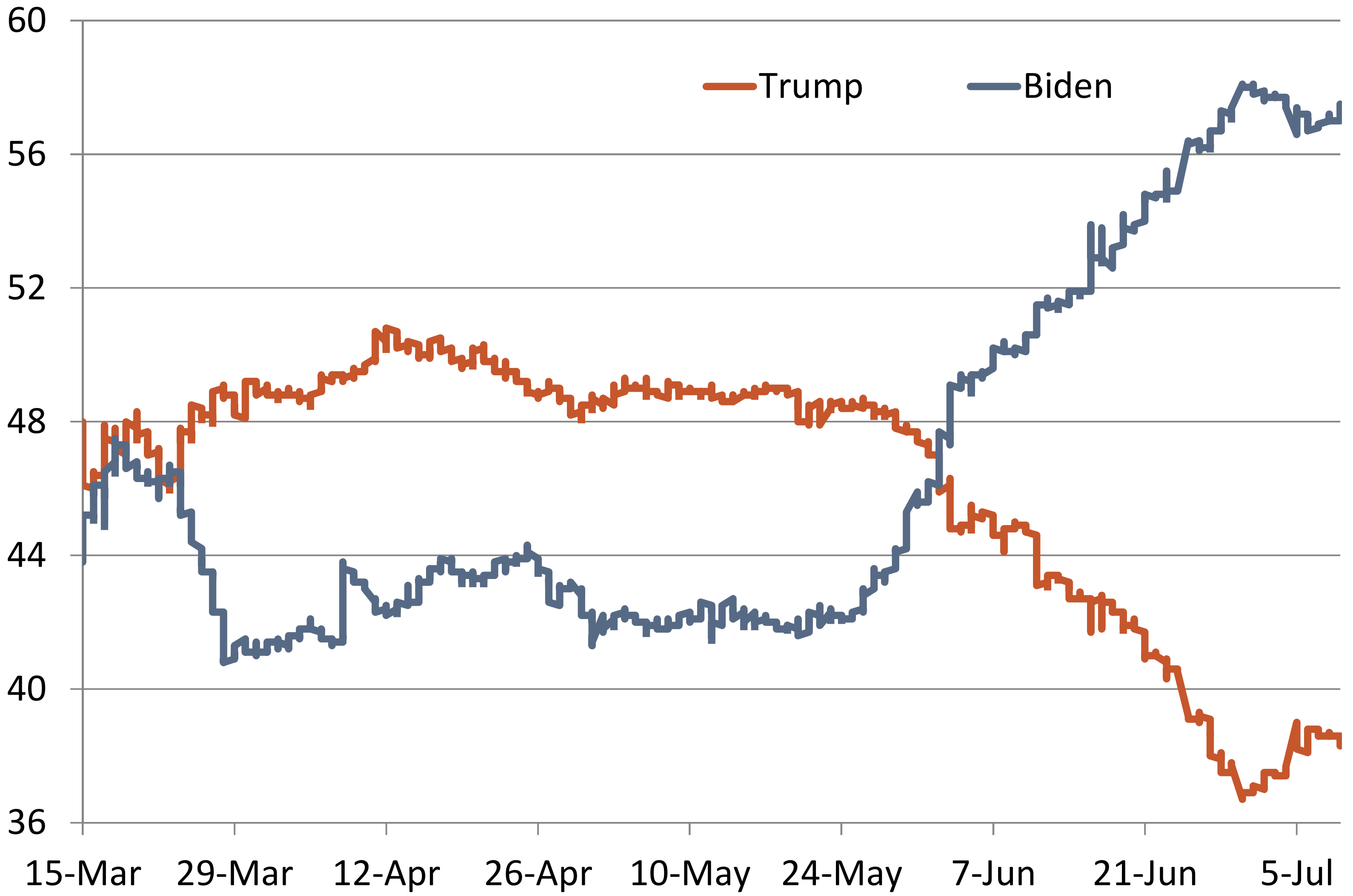
Probability of winning the White House on 3 November 2020

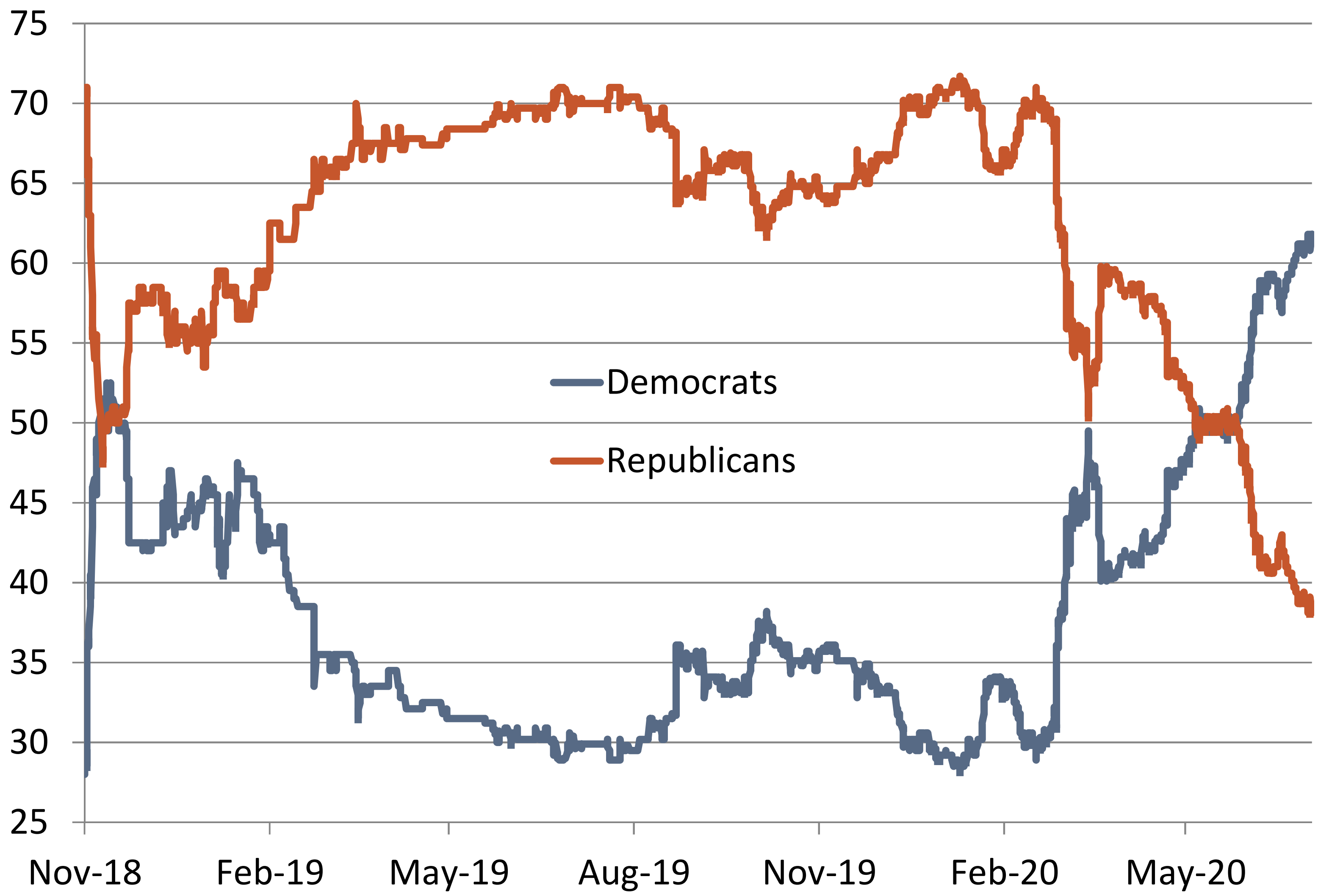


% probability of each candidate winning the White House implied by betting odds. Source: electionbettingodds.com

- With his irritating responses to the pandemic and the events in the wake of the death of George Floyd, US President Donald Trump seems to have raised the chance that (i) Joe Biden will win the election on 3 November and that (ii) Biden's Democrats may even have a majority in both houses of Congress.
- According to electionbettingodds.com, the probability that Trump will be re-elected has fallen from 50% at the end of last year to just 38% now.
- Joe Biden is now ahead with a 58% probability, up from below 42% earlier this year.

US elections: Democrats may also win the Senate

Betting odds: Chance of winning control of Senate



In %. Source: electionbettingodds.com

- The Democrats are the clear favourite to maintain the House.
- Since the events related to the death of George Floyd, the Democrats are now ahead in the race to win the Senate as well.
- Beyond the modest domestic re-regulation which Biden could enact as president, a Democratic majority in both houses of Congress would allow Biden to also implement a more centre-left legislative agenda.
- The resulting mix of more domestic regulation with a calmer foreign and trade policy may sour the economic mood in the US but still come as a relief to the rest of the world.

But it is early days …

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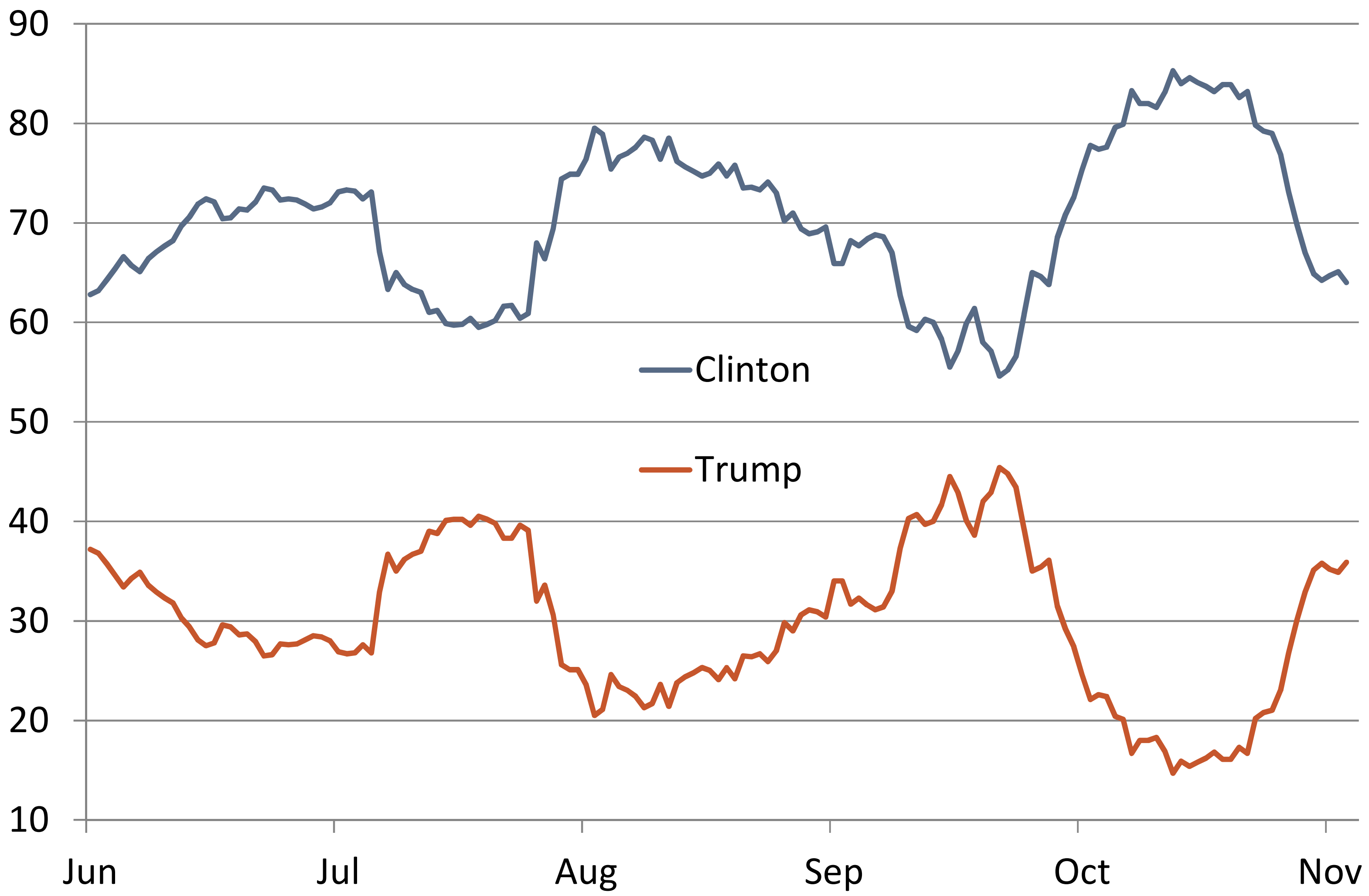
US opinion polls ahead of 2016 presidential elections



Probability of victory in % based on a "polls-plus forecast" model.
Source: FiveThirtyEight.

- The election outcome on 3 November remains wide open.
- The 2016 election teaches lesson of caution.
- Trump is a proven campaigner who can mobilise his base.
- But recent events may now be mobilising the base of the Democrats more than in 2016. The odds are tilting slightly against Trump and the Republicans.

Biden vs. Trump

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Biden: Progressive Democrat

- Biden favours higher spending and taxes and and more govt. regulations, $15 minimum wage
- More progressive than Hillary Clinton in 2016
- Tough on China but no tariffs; friendly toward Europe, Canada
- Re-enter Paris climate accord
- Pro-union stance
- Increasingly influenced by the progressive left on economic and social issues

Trump: Erratic Republican

- Favours higher spending but holds lines on taxes; less regulations
- Hard line on China; depicts Europe/Germany as economic threats to US, favours tariffs as a lever
- Aggressively against global and multilateral institutions on almost all issues
- Erratic and unpredictable; autocratic

Biden's official tax policy platform

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Raise taxes $5.5 trillion over ten years

Personal taxes

- Raise individual rate for high earners to 39.6% from 37%, tighten loopholes; tax capital gains as ordinary income at 43.4% rate for high earners with adjusted gross income above $1 mil
- Payroll taxes: raise 0.4 ppt on all wages, eliminate tax maximum on old-age and survivors' insurance and similar incomes for high wage earners
- Estate taxes: lower thresholds for assessing estate taxes and end step up in basis at death

Corporate taxes

- Raise rate from 21% to 28%, with 15% minimum book tax
- 21% minimum taxes on overseas income
- End 20% tax cut for privately owned (pass through) businesses
- Tax credits for renewables
- End deductions for fossil fuels and pharmaceutical advertisements

Merkel: surge in popularity gives her chance to act

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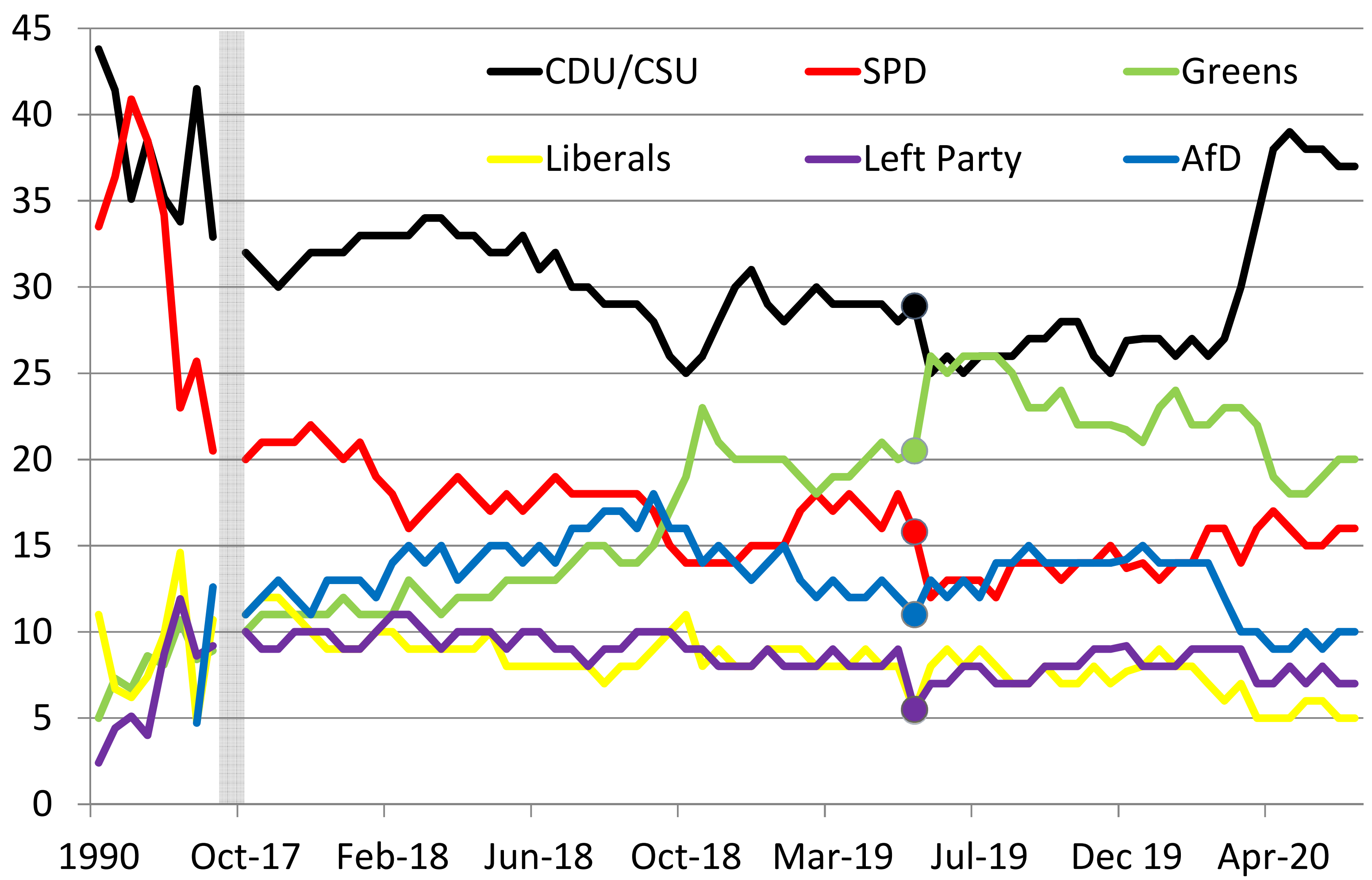
German election results and opinion polls, support for political parties in %



Election results 1990-2017; "ARD DeutschlandTrend" opinion polls thereafter, 5-poll average for last observation, the dots mark the European election result of 26 May 2019. Sources: ARD, INSA, Forsa, FG Wahlen, Emnid, YouGov

- Old allegiances (workers vote SPD, rural regions vote CDU/CSU) weaken. The traditional "Volksparteien" have lost their dominance.
- The centre-left Greens and the Left Party have chipped away at support for the SPD.
- After the 2015 refugee crisis, the right-wing AfD made heavy inroads into the voter base of CDU/CSU and SPD.
- Thanks to Merkel's deft handling of the corona crisis, support for the CDU/CSU has rebounded strongly.
- That gives Merkel the political capital she needs to forge a compromise on a €750bn support package for the EU.
- The risk of a Green-red-red majority after the September 2021 elections has receded – but not vanished. What if FDP falls below 5%?

Italian politics: Salvini loses ground – to the ultra right

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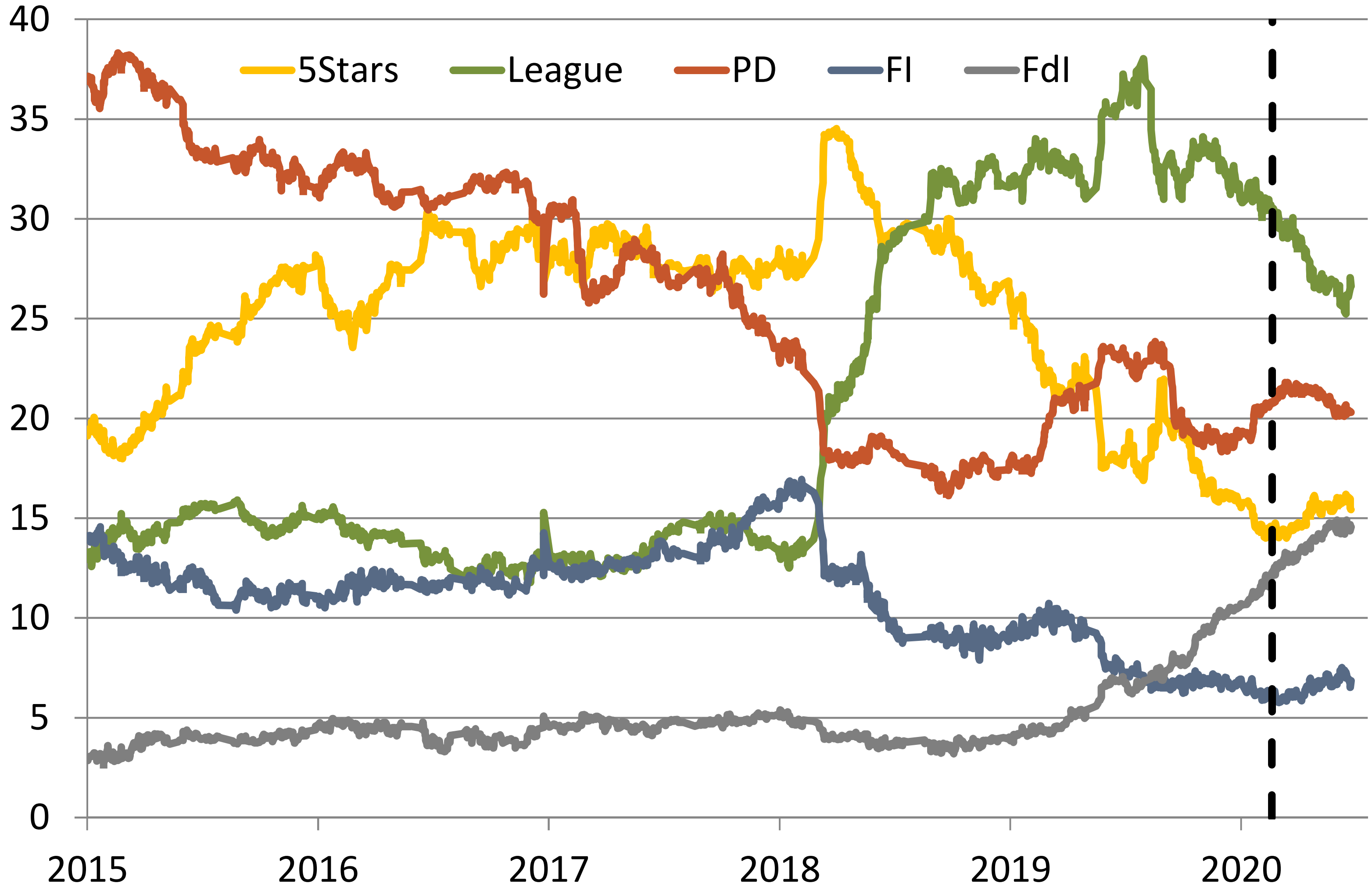
Italian opinion polls: pandemic reshuffles the populist deck



M5S: 5 Stars (Di Maio), LN: Lega (Salvini); PD: centre-left Democratic Party, FI: centre-right Forza Italia (Berlusconi); FdI: right-wing Fratelli d'Italia (Meloni), average of 7 latest available polls, vertical line marks beginning of Covid-19 pandemic. Sources: National opinion polls, Berenberg calculation.

- After the radical 5Stars and Lega formed a coalition in June 2018, support for the Lega surged while 5Stars lost their shine.
- When Lega leader Matteo Salvini brought down the first Conte government in mid-2019, 5Stars and centre-left Democrats struck a deal to avoid new elections instead.
- The Covid-19 has hit parts of Northern Italy hard where the Lega leads many regional governments.
- Salvini's Lega has now lost support – to the even more radical Fratelli d'Italia (FdI).
- Unlike the Lega, the FdI sound more serious about leaving the EU and the euro.
- Italy remains the key political risk to watch in the Eurozone.
- The €750bn package helps to contain the risk.

European politics: €750bn recovery fund

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The biggest cross-border solidarity package ever

The €750 bn recovery fund (= 5.4% of EU 2019 annual GDP)

- €500bn in grants, €250bn in loans, to be disbursed 2021-2024
- Financed by EU bonds, to be repaid through the EU budget 2028-2058
- Expect progress but no deal yet at summit on 17-18 July, further summit in late July or early August?
- Discussions on details likely to drag on until late 2020
- The pressure on all sides to agree is huge = deal likely in the end
- German concessions such as a bigger German contribution to the EU's 2021-2027 budget can help to clinch a deal

Merkel: six months to leave a European legacy

- Germany chairs the EU Council in 2H 2020
- Merkel's influence will wane in late 2020 once the CDU/CSU have nominated a candidate to succeed her in autumn 2021.
- In discussions about money, Germany as the financial anchor of the EU/Eurozone matters even more than usual.

A great opportunity: a carrot instead of a stick

- In the euro crisis, Europe used the stick of potential default to goad Greece, Portugal, Spain, and Cyprus into (overdone) austerity and serious pro-growth reforms – all countries raised the growth potential as a result
- Europe may now use the carrot of €173 bn support for Italy to goad Rome into pro-growth reforms (less bureaucracy, faster, judicial procedures….) . Stronger trend growth would help Italy to overcome its long-term malaise. Outcome unclear – but worth a try. If Italy does not raise its trend growth, a debt crisis may loom once rates and yields rise again

Eurozone common debt: Not quite a "Hamilton moment"

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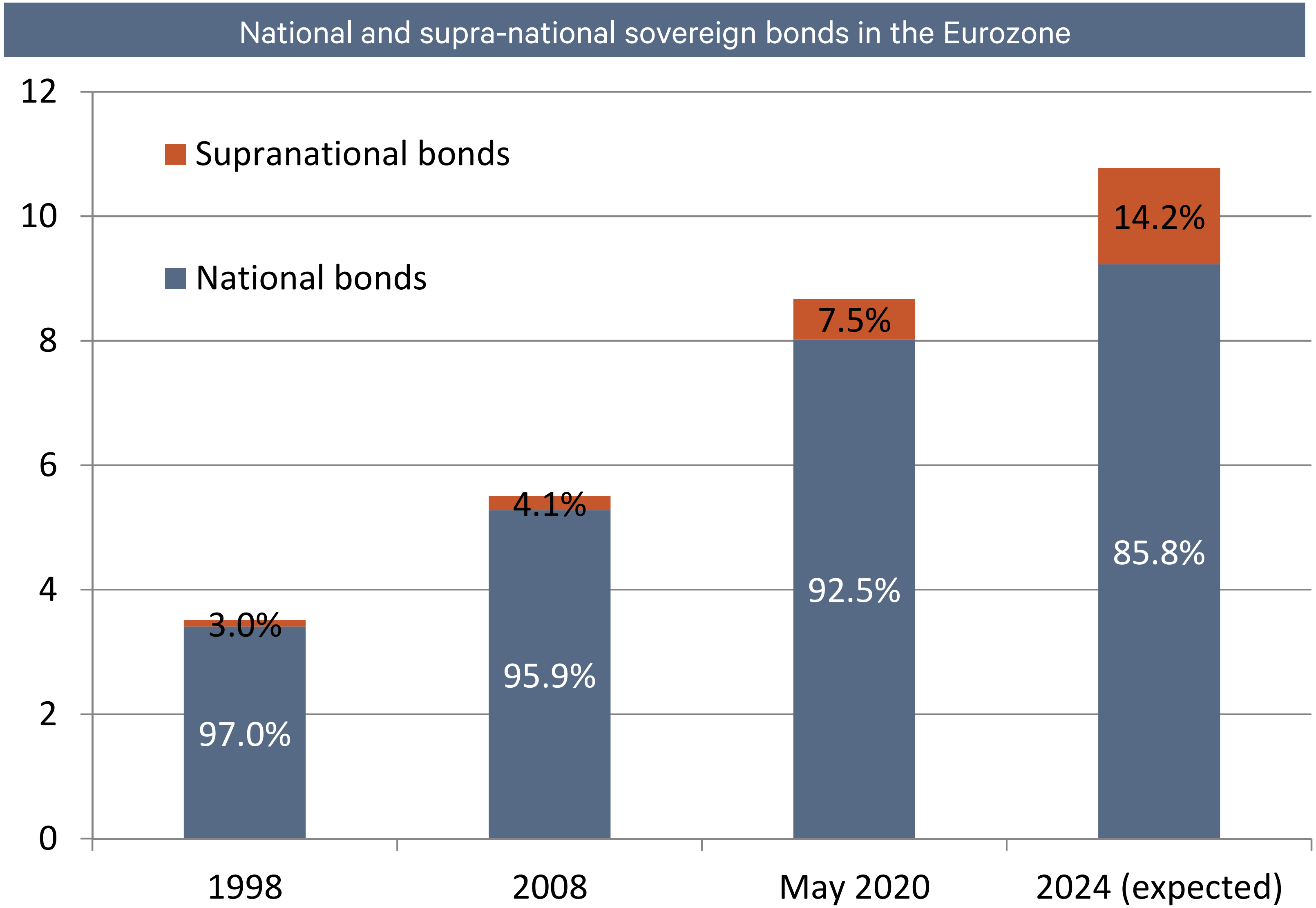

- For the EU and the Eurozone, the €750bn recovery fund marks a major step forward.
- But it does not come close to a "Hamilton moment" of federalising US states' debt in 1790.
- Even with €100bn for the EU's "SURE" labour market support scheme, a €200bn increase in EIB lending capacity and €75% EM credit lines…,
- ….the jointly guaranteed debt of the 19 Eurozone members will merely rise from 7.5% now to 14:2% of total Eurozone sovereign debt in 2024.

Eurozone sovereign bonds (including EIB bonds) in €trn, numbers in the bars give their share of the total. Source: Eurostat, European Commission, Bloomberg, Berenberg

Brexit: some signs of progress

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Recent progress on key issues raises the hope of a deal

The UK left the European Union on 31 January 2020. It wants to exit the Single Market and Customs Union on 31 December 2020. Talks on the future UK-EU relationship are moving slowly. To be ratified in time, a deal should be struck by the end of October 2020.

- UK unwilling to extend transition period, end-June deadline to do so has passed
- Some progress on key issues of late including the Irish border, level playing field, governance and fisheries
- More intense talks with weekly meetings started on 29 June, they can only yield an ambitious deal if UK softens its stance
- EU negotiators unlikely to deviate from the mandate given by the 27 member states
- As our base case, we expect the UK and the EU to agree on a series of temporary stopgaps to cushion the blow of a hard exit at the end of 2020 (60% probability). We see a 35% chance of a substantial deal that goes beyond a patch-work of stopgap measures
- The tail-risk to watch – a complete breakdown in negotiations that ends with a disorderly hard exit (5% probability)

Potential consequences:

- Before the Brexit vote, the UK had trend growth of c2.0%
- Even with an ambitious deal that preserves privileged UK access to the big EU27 market, UK trend growth will fall to c1.7%
- A hard exit from the EU market would lower UK trend growth to c1.5%
- The short-term shock in 2021 in case of a disorderly hard exit could tip the UK back into recession
- The UK earns 12% of its GDP through exports to the EU27; four times more than vice versa. The shock to the EU of a hard UK exit from the EU market would be much smaller

UK economic outlook – the key issues

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Despite good fundamentals and aggressive economic policy support the near-term risks are tilted to the downside

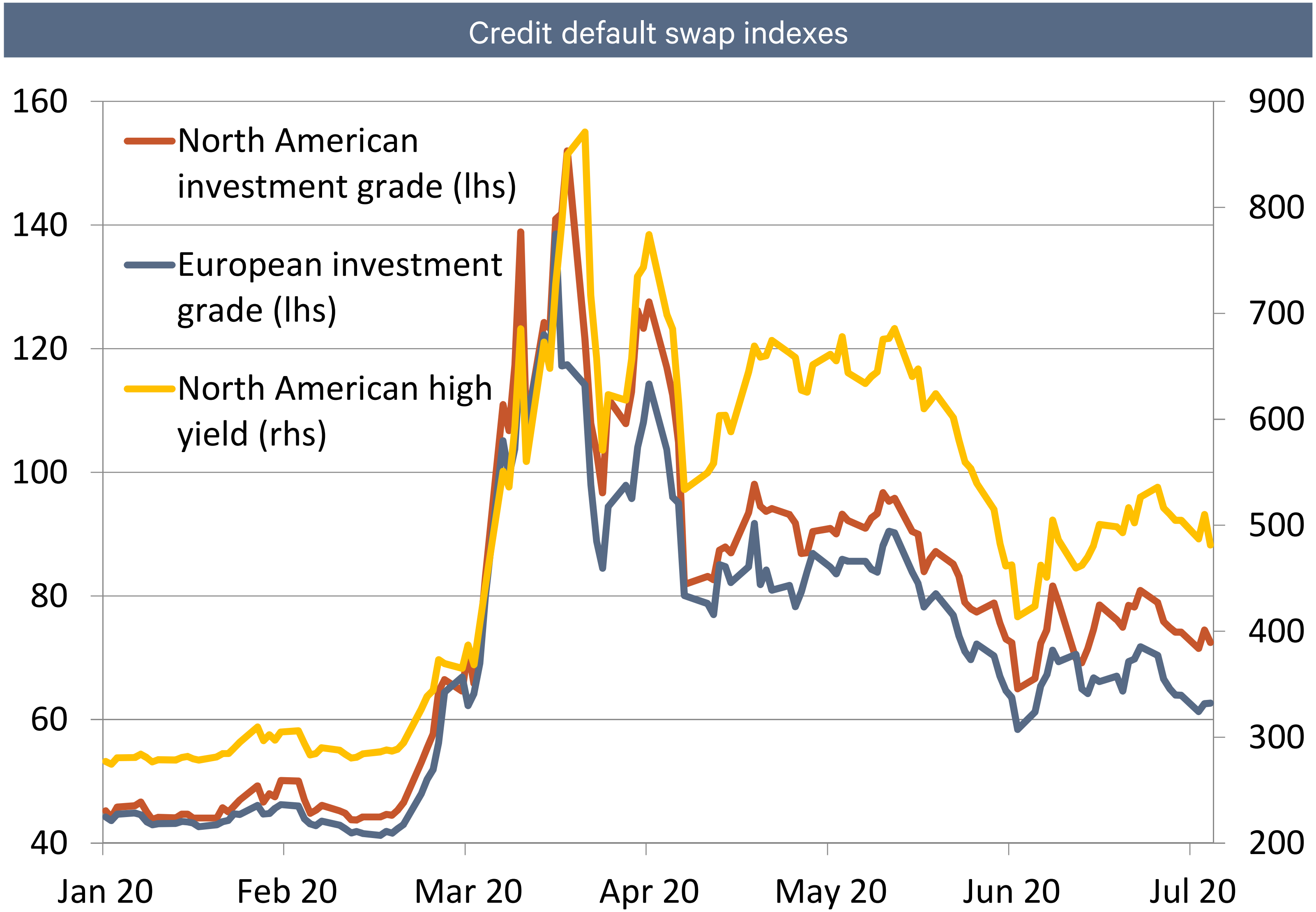
On track for a tick-shaped rebound – but watch the risks

- Having reacted late to the first wave of the virus, the UK was forced to introduce a severe lockdown on 23 March to contain its spread. UK economic output contracted by roughly 25% from February to April.
- As the UK initially lagged behind in bringing the virus under control, it is easing its lockdown later than major parts of Europe. Still, the evidence points to an economic that recovery started in early-May and gained momentum in June.
- Following a partial snap-back in the coming months following the easing of the most-economically significant restrictions, GDP will return to its late 2019 level in early 2023 – a year later than major parts of Europe.
- For 2020, the risks are tilted to the downside as continued virus risks and Brexit uncertainty weigh on confidence. For 2021 the risk are balanced. For 2022 and beyond, we see potential upside.

Economic policy – shifting from rescue to recovery

- With inflation and growth risks tilted to the downside, the potential costs of an economic policy error are asymmetric. The risks associated with providing too much stimulus are much lower than the risks associated with providing too little.
- The BoE added an extra £100bn to its asset purchases on 18 June. This may be it. But if the economy were to underperform, the BoE could buy more. Could the UK go for negative rates? Unlikely, not impossible.
- On the fiscal side, the UK has taken steps to support job creation and raise productivity in the laggard regions of Northern England – higher spending on infrastructure and healthcare. More stimulus to come in Autumn (late-Nov/early-Dec).
- Should we worry about public debt? Not yet. The UK can afford to focus on supporting economic output as its priority. However, measures to tackle the additional fiscal burden need to come later on once a sustainable recovery is assured.

Crisis basics: preventing a credit crunch



- In 2008, a credit crunch turned into a cash flow crunch. Today, the risk is that a cash flow crunch could turn into a credit crunch.
- Policymakers reacted quickly when credit risks started to surge in late March – debt guarantees and injections of central bank liquidity have calmed credit markets.
- Financial crisis averted? Not yet. Policymakers will need to support credit markets until the economic recovery gains momentum.

Daily data. Source: Bloomberg

Crisis basics: preventing a credit crunch

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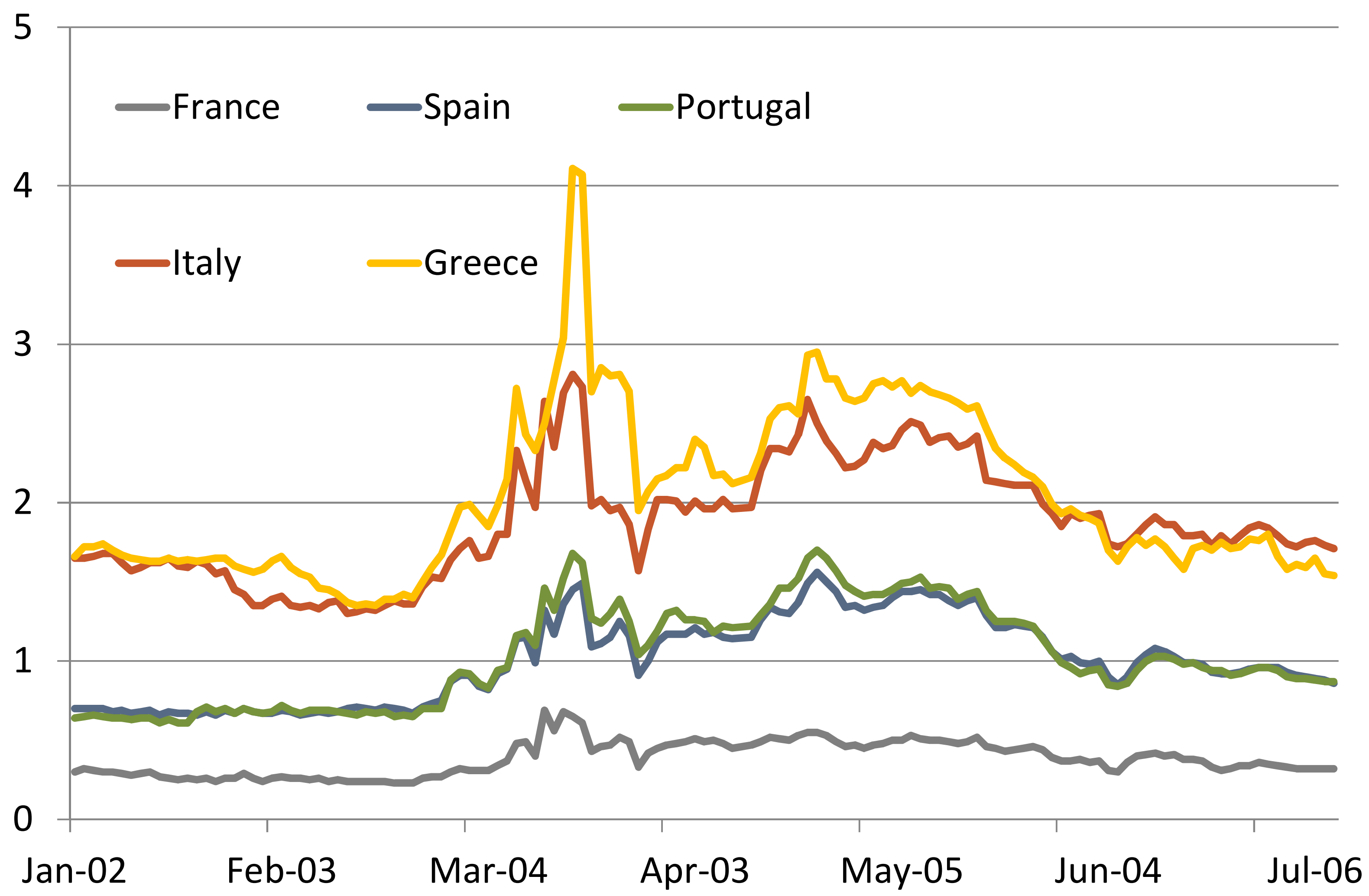
Eurozone sovereign 10-year bond spreads



Spreads over 10-year German bond yields . Source: Refinitiv, Berenberg..

- Whatever it takes: In the Eurozone, the European Central Bank and national finance ministers have reacted fast and strongly to contain the economic damage.
- The common European fiscal response has been more muted but is starting to take shape.
- With a proposal for a €500bn "grants-only" recovery fund, France and Germany have taken a big step. The European Commission added another €250bn in loans.
- Does it reign in anti-EU sentiment which has surged in Italy? It poses a serious threat to the cohesion of the EU and the euro in the long run.

Bond yields hit fresh lows as public debt surges

The UK example: borrowing costs remain at historic lows despite record debt issuance

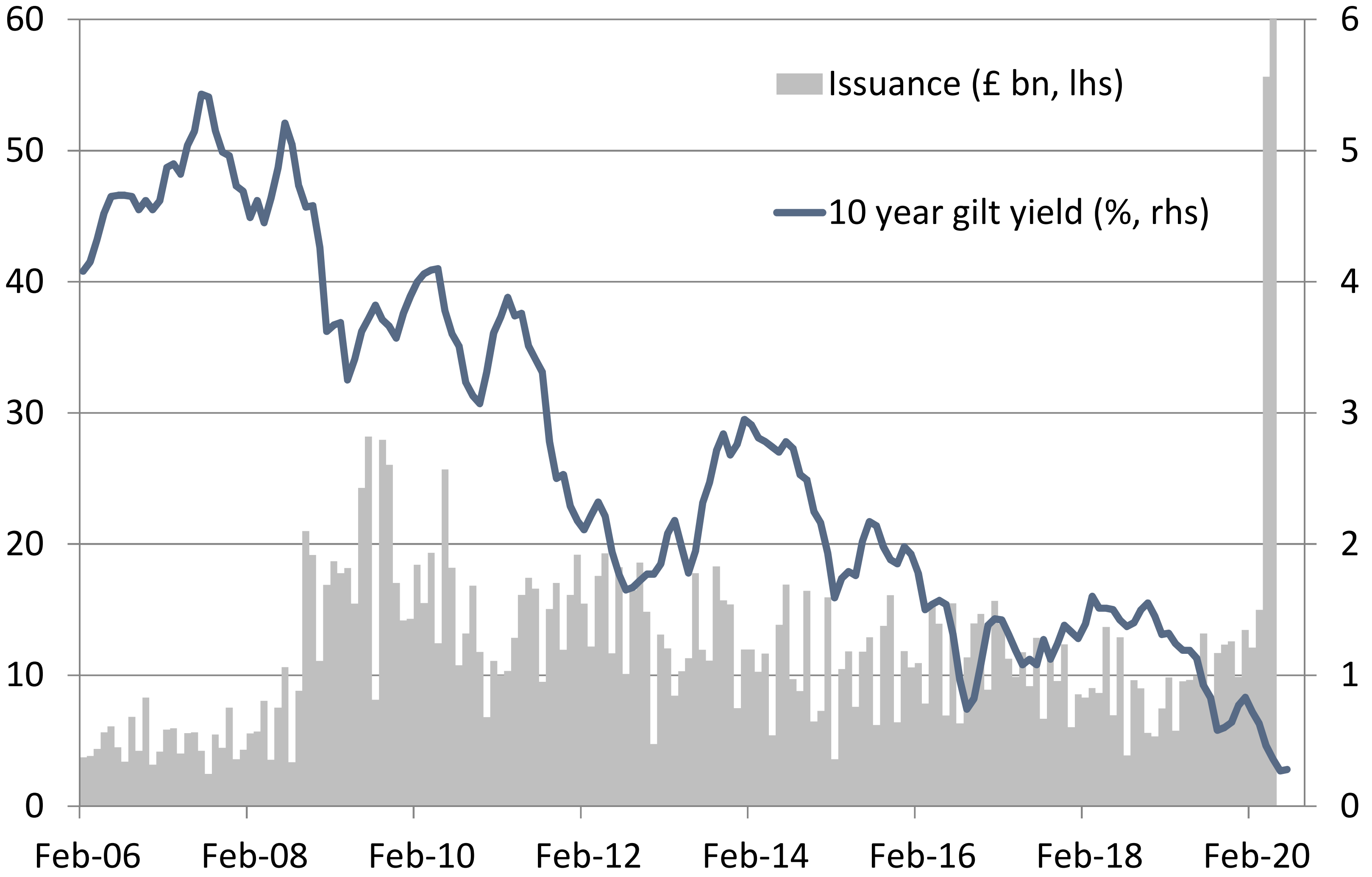


Chart shows UK data as a representative example of trends across the advanced world. Monthly data. Source: Debt Management Office, Bank of England

- Benchmark interest rates, such as those on government bonds for major advanced countries, have declined to record lows across the advanced world despite the surge in public debt.
- The pandemic has reinforced three interlinked factors that had pushed bond yields down over the past decade: 1) a rising glut of global savings seeking a safe haven versus declining investment opportunities in the advanced world: 2) declining inflation and inflation expectations: and 3) massive central bank balance sheet expansions.

What could the post-COVID-19 world look like?

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Five ways in which the world could look different after the downturn

A greater role for the state: The pandemic has revealed: 1) the inability of existing facilities – especially healthcare – to handle a sudden surge in demand, and 2) a reliance on long-distance imports for crucial medicines and equipment. Expect governments across the world to take the necessary steps to better prepare for a future medical emergency, involving: a larger role for the state, some regulatory change and a more active trade and industrial policy to promote strategic industries like healthcare and defence.

More fiscal activism: The big policy response will likely work – no repeat of the 2008/2009 financial crisis. Countries that have taken the most aggressive action will likely experience the least long-term damage. As long as inflation risks remain contained and markets do not penalise governments too much for taking on the extra debt, policymakers may be inclined to turn to other economic problems – weak productivity, income inequality – with more debt-financed fiscal activism in the future.

Nature of globalisation changes: Reacting to the disruption in global trade flows and supply chains, manufacturing and production industries will shorten and diversify supply chains and raise inventories. A public policy response to "onshore" strategic industries and produce vital medicines and equipment at home will add to this trend of deglobalisation in goods trade. However, the ongoing globalisation of ideas can offset the damage from some de-globalisation in the goods sector.

Accelerated innovation: The coronavirus shock is likely to spur innovation in many fields, ranging from a more efficient use of labour and communications technology to increased use of 3D printing. If working habits change permanently, especially regarding working from home, that will further raise demand for technologies that facilitate remote working.

More inflation in the long run? This is more of a risk rather than a likely outcome. The need for post-recession fiscal repair and the rise in unemployment during the downturn suggest that inflationary pressures will be very subdued for a while. However, during the latter stages of the recovery, less elastic global supply may meet the lagged impact of fiscal activism and could push inflation modestly higher over time. The gradual aging of societies points in the same direction.

Global economic forecasts

	Weight	GDP growth				Inflation				Unemployment				Fiscal balance			
		2019	2020	2021	2022	2019	2020	2021	2022	2019	2020	2021	2022	2019	2020	2021	2022
World*	100.0	2.4	-4.3	3.4	2.3												
US	24.2	2.3	-4.1	3.5	2.5	1.8	0.7	0.6	1.5	3.7	8.4	7.2	5.7	-2.9	-17.0	-12.0	-11.0
China	15.8	6.2	-3.0	4.0	3.8	2.9	3.3	2.1	2.1	3.6	5.0	4.6	4.4	-3.8	-9.5	-9.8	-8.8
Japan	5.9	0.7	-4.5	3.6	1.1	0.5	0.1	0.2	0.5	2.4	2.9	3.0	2.7	-3.6	-11.0	-9.0	-8.0
India	3.2	5.0	-2.5	3.5	4.0									-2.2	-9.0	-6.0	-4.0
Latin America	6.2	1.5	-6.0	3.5	2.5									-4.6	-10.0	-7.0	-4.0
Europe	25.7	1.2	-7.5	5.6	2.6												
Eurozone	16.1	1.2	-8.0	6.2	2.7	1.2	0.4	0.8	1.4	7.6	7.8	8.2	7.6	-0.8	-11.5	-6.0	-3.0
Germany	4.7	0.6	-6.0	4.7	2.4	1.4	0.2	1.6	1.4	3.2	4.5	4.8	4.0	1.5	-9.0	-5.0	-2.5
France	3.3	1.5	-10.7	8.6	3.1	1.3	0.4	0.7	1.4	8.5	9.1	9.0	7.1	-3.2	-11.0	-6.0	-3.5
Italy	2.4	0.3	-11.3	7.7	2.2	0.6	-0.2	0.7	1.2	9.9	9.2	9.6	8.0	-1.6	-13.5	-6.0	-3.5
Spain	1.7	2.0	-10.6	8.4	3.6	0.8	-0.2	0.7	1.3	14.1	15.5	15.4	13.7	-2.4	-13.0	-6.5	-3.5
Portugal	0.3	2.2	-9.3	7.4	3.0	0.3	0.3	0.8	1.4	6.6	7.6	8.2	6.8	-0.7	-10.5	-5.5	-3.0
Other Western Europe																	
UK	3.3	1.5	-8.3	5.4	2.1	1.8	0.0	1.4	1.8	3.9	6.2	7.0	6.2	-1.6	-11.0	-5.0	-3.0
Switzerland	0.8	0.8	-6.5	5.0	2.6	0.6	0.0	0.6	0.9	2.3	4.3	4.0	3.2	3.9	-7.5	-3.0	-1.0
Sweden	0.7	1.3	-6.0	5.0	2.6	1.8	0.9	1.3	1.5	6.3	8.0	7.2	6.8	0.5	-7.5	-3.0	-1.5
Eastern Europe																	
Russia	1.9	1.0	-5.0	3.5	2.5	4.5	2.0	3.0	3.9	4.6	7.0	5.0	4.7	2.1	-6.0	-4.0	-1.5
Turkey	0.9	-1.2	-6.0	3.5	3.0	15.2	9.0	8.5	8.0	14.0	18.0	15.0	13.0	-4.0	-9.0	-7.0	-4.0

Unemployment rate: Harmonised definition (ILO/Eurostat); fiscal balance: general government deficit in % of GDP excluding one-off bank support.

Official European unemployment rates are skewed downward in 2020 and H1 2021; workers receiving wage subsidies while furloughed are counted as employed in Europe while people on "temporary layoffs" are counted as unemployed in the US. In addition, in France, Italy, Spain and Portugal, many workers who were unable to search for work during the lockdown were classified as not participating in the labour market rather than unemployed - this further skews down their unemployment rates in H1 2020.

*At market exchange rates, not purchasing power parity. PPP estimates give more weight to fast-growing emerging markets and inflate global GDP.

Weights based on IMF World Economic Outlook statistics 2018 GDP figures. Source: Berenberg

Key financial forecasts

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	Current[1]	End-2020	Mid-2021	End-2021	End-2022
Central bank rates					
US Fed	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.00-0.25%
ECB refi	0.00%	0.00%	0.00%	0.00%	0.00%
ECB deposit rate	-0.50%	-0.50%	-0.50%	-0.50%	-0.50%
BoE	0.10%	0.10%	0.10%	0.10%	0.10%
BoJ	-0.10%	-0.10%	-0.10%	-0.10%	-0.10%
10-year bond yields					
US	0.58%	1.10%	1.25%	1.40%	1.80%
Germany	-0.48%	-0.20%	-0.10%	0.10%	0.50%
UK	0.14%	0.40%	0.50%	0.60%	1.00%
Currencies					
EUR-USD	1.13	1.15	1.16	1.17	1.20
EUR-GBP	0.90	0.91	0.90	0.88	0.88
GBP-USD	1.26	1.26	1.29	1.33	1.36
USD-JPY	107	108	108	108	108
EUR-JPY	121	124	124	124	124
EUR-CHF	1.06	1.08	1.10	1.11	1.12
USD-CNY	7.00	7.10	7.10	7.10	7.10

1 Taken on 10 July 2020. Currency forecasts may not add up due to rounding.

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