N° 39 | April 2020

SCÉNARIOÉCO

SG Economics and Sector Studies

Interim forecast update

- The Covid-19 outbreak has caused tragic human loss and suffering. Governments around the World have introduced non-pharmaceutical interventions (NPI) in a bid to flatten the epidemiological curve, to allow health care systems to cope, and save human lives. NPI, however, comes at a high immediate economic cost.

- Although gauging the economic cost of the Covid-19 crisis remains an uncertain exercise, not least given the many unknows as to how long NPIs might remain in place, it is clear already that the scope of these measures expands well beyond the working assumptions that underpinned our previous forecast, necessitating this interim update.

- In presenting a set of new forecasts we draw both on bottom-up sector expertise and top-down analysis, taking account of the tremendous policy response. Reflecting the current uncertainty, moreover, we also show what a prolonged extension of NPI could entail.

- Already prior to the current crisis, debt levels across most of the major economies were elevated and given that many of the current losses are being transformed into future debt, this points to a further weakening of trend potential growth and continued financial repression.

- The major central banks, and not least those with currencies that hold reserve status, are forecast to continue large scale asset purchase programmes and liquidity supporting operations. This policy option, however, is not open to all economies and available policy room has become a critical factor for many, not least in a setting where global co-operation remains lacklustre. Moreover, it seems unlikely that China this time round, has the room or appetite to drive an investment expansion on a similar scale to that observed post 2008/09.

- Risks to our outlook remain on the downside, not least as the current crisis increases the risk of a new shock, be it financial or geopolitical.

SUMMARY

The rapidly evolution of the Covid-19 health crisis means that the working assumptions on which we based our economic scenario in early March, are no longer valid. We thus share new headline forecasts with this interim update and will return with a full economic scenario in June.

Our previous forecast assumed a return to normal by the end of the second quarter of 2020 and an aggressive policy response to support the economy, both during the phase over which non-pharmaceutical intervention (NPI), such as social distancing and closures, is in place, and during the post-NPI recovery phase. Subsequent events mean that both these assumptions are today challenged.

Covid-19 has continued to spread around the world causing tragic loss of human life and suffering. Governments, in response, are adopting more extensive NPI in a bid to stem the health crisis and save lives. Such measures, however, come at a significant economic cost.

Our interim update makes the new working assumption of a return to near normal by late 2020 but this working assumption remains subject to significant uncertainty.

Top of the list, the health crisis could deepen further, prolonging the crisis. Reflecting this uncertainty, we also present an alternative scenario that delays the time to return to near normal conditions; by one quarter.

On the policy front, governments and central banks have delivered tremendous support in terms of liquidity and credit guarantees. Significant measures have also been taken to support households and businesses most impacted by the economic effects of NPI. Our concern remains, however, that the policy response to support the recovery phase remains under-dimensioned at this stage. This is true, not least given that many of the current losses are being transformed into future debt, which will weigh on trend potential growth.

The tables below summarise our baseline scenario, and the charts on the following page illustrate the range offered by our "prolonged" scenario. Please note, that our alternative scenario does not discount additional downside risks, such a new round of coronavirus in 2021, more durable damage to the supply side, a major financial failure or a geopolitical crisis. As such, our two scenarios come with significant downside risk, and not least over the medium term.

ECONOMIC FORECASTS

Real GDP growth (annual, %)	2019e	2020f	2021f	2022f	2023f
Developed Markets	***1.7***	***-6.0***	***5.6***	***1.0***	***1.4***
United States	2.3	-6.6	6.1	0.9	1.7
Japan	0.7	-2.3	1.6	0.5	0.5
United Kingdom	1.4	-6.8	6.3	0.8	1.0
Euro area	1.2	-6.8	6.6	0.7	1.2
Germany	0.6	-7.3	7.5	0.5	1.3
France	1.3	-5.8	6.0	0.7	1.1
Italy	0.3	-7.7	6.5	0.4	0.7
Spain	2.0	-7.5	8.1	1.0	1.3
Emerging Markets	***3.7***	***0.7***	***5.6***	***3.8***	***3.8***
Asia	5.1	2.0	6.6	4.7	4.6
China	6.1	2.9	7.3	4.8	4.6
India	4.5	1.5	5.6	4.5	4.5
Central and Eastern Europe	1.9	-2.1	4.0	2.2	2.3
Russian Federation	1.3	-3.0	2.0	1.5	1.5
Turkey	0.2	-4.0	8.5	3.5	3.5
Latin America	1.0	-1.8	4.2	2.6	2.8
Brazil	1.1	-3.5	3.4	2.1	2.4
Middle East & Central Asia	-0.5	-1.0	3.0	2.0	1.8
Africa	3.2	0.2	4.5	3.0	3.5
World	***2.9***	***-2.3***	***5.6***	***2.8***	***3.0***

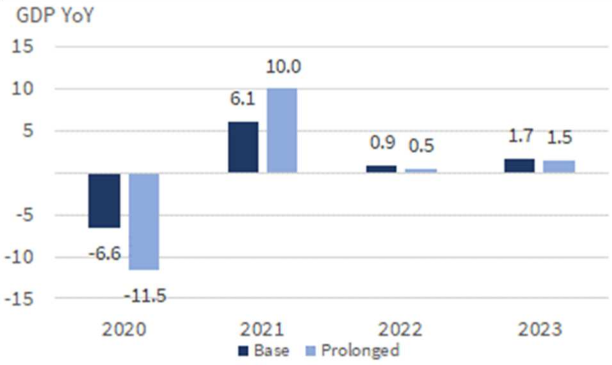
All averages (regional, economic classification) are computed using GDP expressed at Purchasing Power Parity (PPP) exchange rate. PPP exchange rates are used to equalise the cost of a standardised basket of goods between different countries

end of period	13-Apr.	2020f	2021f	2022f	2023f
Interest rates, %					
United States					
Fed Funds target rate (high range)	0.25	0.25	0.25	0.25	0.25
10y government bonds	0.70	0.80	1.00	1.50	2.35
Euro area					
Refinancing rate	0.00	0.00	0.00	0.00	0.00
Deposit facility rate	-0.50	-0.60	-0.60	-0.60	-0.60
10y government bonds					
Germany	-0.34	-0.60	-0.40	0.20	0.65
France	0.11	-0.20	-0.10	0.50	0.95
Italy	1.60	1.80	1.90	2.50	2.95
Spain	0.79	0.40	0.50	1.10	1.45
United Kingdom					
Bank rate	0.10	0.10	0.10	0.25	0.50
10y government rate	0.31	0.40	0.60	1.20	1.75
Japan					
Complementary Deposit Facility rate	-0.10	-0.10	-0.10	-0.10	-0.10
10y government bonds	0.01	0.00	0.00	0.00	0.00

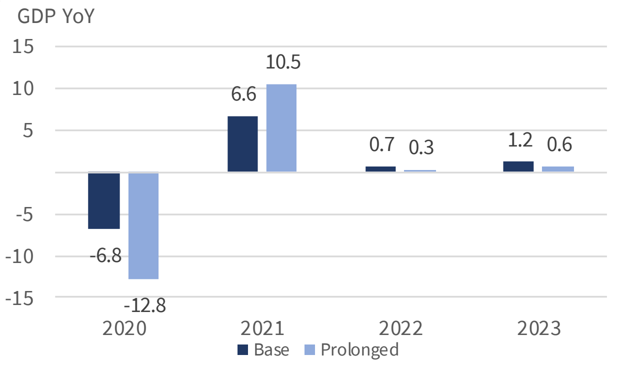
end of period	13-Apr	2020f	2021f	2022f	2023f
Exchange rates					
EUR / USD	1.09	1.10	1.10	1.15	1.20
EUR / GBP	0.87	0.90	0.90	0.90	0.90
GBP / USD	1.25	1.22	1.22	1.28	1.33
EUR / JPY	117	121	121	127	138
USD / JPY	108	110	110	110	115
USD / CNY	7.05	7.00	7.05	7.10	7.05

yearly average	13-Apr	2020f	2021f	2022f	2023f
Oil price					
Brent, $/bbl (Yearly average)	31.7	32	45	55	55

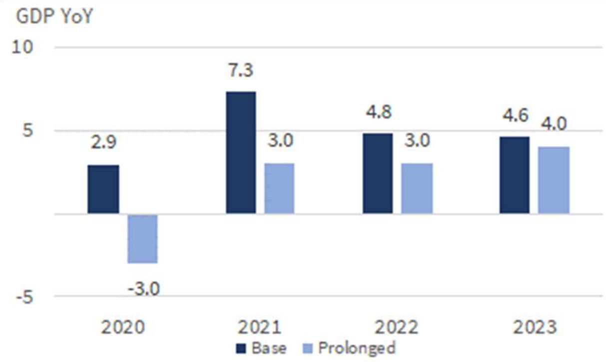
United States



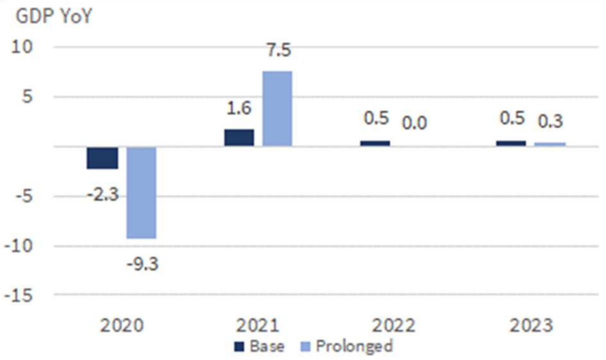
Euro area



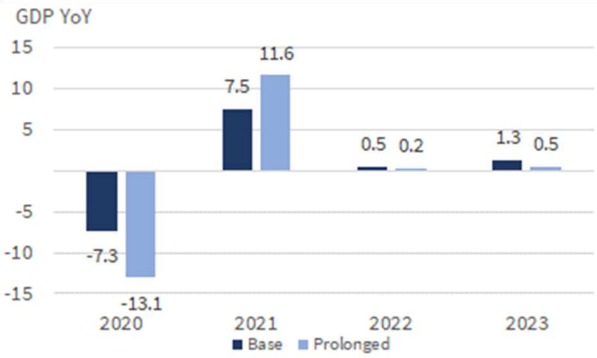
China



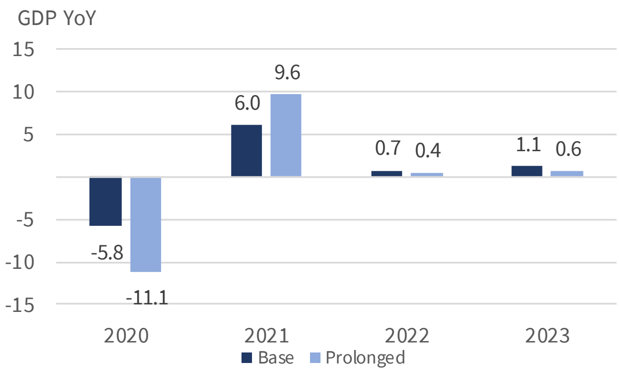
Japan



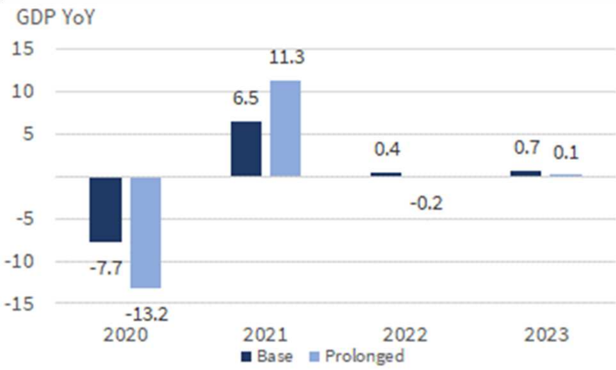
Germany



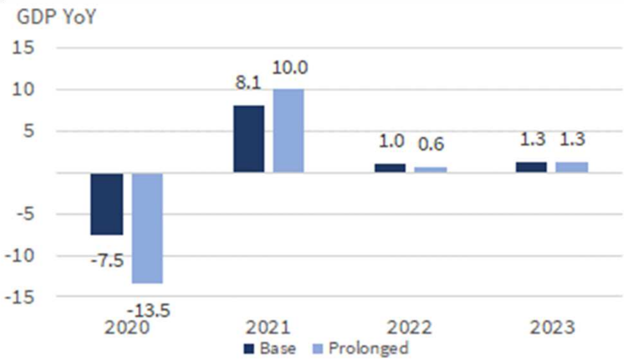
France



Italy



Spain



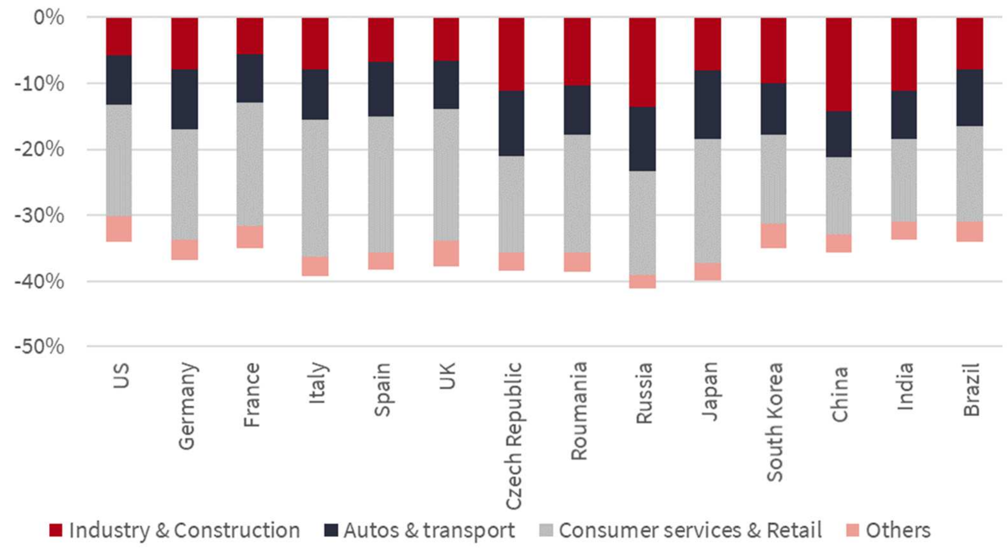
Source: SG Economic and Sector Studies

NON-LINEAR COSTS OF NPIS

Our forecast builds on both bottom-up sector expertise and top down analysis. The chart below illustrates the estimated "mechanical" loss of tough NPI, like those applied presently in France, on an annualised basis. Countries have taken NPI measures to varying speed and degrees; recently more countries have joined the camp of tougher measures, including notably the United Kingdom, the United States and to some degree also Japan.

Estimated direct loss from NPI measures, % GDP

Benchmarked on the French level of social distancing and closure levels, Annual loss



Source: OECD, SG Economic and Sector Studies

The cost of keeping NPI in place increase over time in a non-linear fashion. As such, an additional month of NPI measures would see more than double the subsequent economic impact, and this is due to several channels. Top of the list is greater loss of income for both households and businesses, leading to more precautionary behaviour; lack of visibility only serves to enhance this caution. Next is the headwinds of a prolonged negative financial market response. Third is the observation that as more countries are impacted by the health crisis, the greater the headwind to world trade becomes. Finally, we note that the greater the loss, the higher the future debt and the greater the structural headwind.

Consumer services are particularly hard hit by NPI, and these sectors are also large employers, and not least of low skilled workers in the advanced economies. Services are less likely than manufacturing to readily catch-up lost demand even where household income is available. Nonetheless, manufacturing and construction are also hard hit by the crisis, both from NPI and through supply chains and the afore mentioned trade effects.

An unprecedented policy offset

The very extensive policy response offers welcome offset, and not least in keeping the economy afloat by reducing destruction of supply that a large-scale wave of business defaults would otherwise generate.

Central banks have played an important role, cutting rates where room was available and expanding liquidity support and asset purchase programmes. Based on current measures, the Federal Reserve's balance sheet is set to reach $12tn by the end of September, or 57% of 2019 GDP.

The ECB, for its part, has also taken bold action, with two policy packages aimed at removing fragmentation risk in the euro area (through a major asset purchase programme, the Pandemic Emergency Purchase Programme, amounting to over €1tn by the end of 2020 combined with other asset purchase programmes) and at preserving banks' ability to finance the economy (through a series of liquidity measures).

Government for their part have also stepped in with both income supporting measures and credit guarantees. We also welcome the latest actions by the Eurogroup with proposals of €540bn to support the region. Impressive as many of these programmes are, we continue to see greater need for support in the recovery phase. Our baseline assumption is that further support will indeed be forthcoming, and not least in terms of public plans to support investment.

A need to rebuild balance sheets

Business investment is set to remain lacklustre as corporates seek to rebuild balance sheets post-Covid-19. This echoes the pattern observed in 2008/09 and given that investment spending has one of the highest import intensities, this is set to weigh further on the recovery of global trade.

Protectionist trends, already apparent pre-crisis, are, moreover, likely to continue and not least in a low growth environment. Governments are furthermore set to rethink the organisation of critical supply chains.

Several sovereign balance sheets were under pressure prior to the crisis and while many were able to manage higher debt burdens through a combination of growth and financial repression, the growth side of the equation is now significantly challenged. The crisis, moreover, is adding to what in several case were already high debt burdens.

While most advanced economies' central banks have some capacity to absorb debt through asset purchase programmes and the keep long term interest rates low, most emerging market central banks do not enjoy this option, leaving these economies with reduced policy room and vulnerable.

The deeper the heath crisis, the greater the risk to balance sheet and the risk that additional shocks appear, adding downside risks to our scenario.

A NEW POLICY DEBATE LOOMS

Current efforts rightly remain focused on tackling the crisis, but we note, with interest that a debate on future policy is beginning to emerge. It is a topic that we will have opportunity to develop in future publications, but we already no note a few areas that we see as holding significant potential.

Top of the list is the completion of the European architecture, with Banking Union, Capital Markets Union, some form of Fiscal Union and Energy Union.

Second is the ambition of new green deals to tackle climate change, thus lifting near-term growth opportunities and reducing the risk of future sudden stoppage shocks. The current Covid-19 crisis offers a stark warning of what sudden stops entail.

Third is the need to focus on reducing inequality not least with investment in education to ensure better opportunities for all, not least in the face of digitalisation.

Finally, we note a debate to transform part of the current debt into equity, and idea that we welcome. Past crises have often been linked to excessive debt burdens and a focus on a greater role for equity could mark and important turning point.

CONTACTS

Michala MARCUSSEN
Group Chief Economist
+33 1 42 13 00 34
michala.marcussen@socgen.com

Olivier de BOYSSON
Emerging Markets Chief Economist
+33 1 42 14 41 46
olivier.de-boysson@socgen.com

Marie-Hélène DUPRAT
Senior Advisor to the Chief Economist
+33 1 42 14 16 04
marie-helene.duprat@socgen.com

Ariel EMIRIAN
Macroeconomic analysis
+33 1 42 13 08 49
ariel.emirian@socgen.com

François LETONDU
Macro-sector and macro-finance analysis
+33 1 57 29 18 43
francois.letondu@socgen.com

Constance BOUBLIL-GROH
Central & Eastern Europe, Russia
+33 1 58 98 98 69
constance.boublil-groh@socgen.com

Olivier DENAGISCARDE
Macro-sector analysis
+33 1 58 98 74 22
olivier.denagiscarde@socgen.com

Juan Carlos DIAZ MENDOZA
Americas
+33 1 57 29 61 77
juan-carlos.diaz-mendoza@socgen.com

Clément GILLET
Africa
+33 1 42 14 31 43
clement.gillet@socgen.com

Erwan JAIN
Macro-sector analysis
+33 1 58 98 05 35
erwan.jain@socgen.com

Alan LEMANGNEN
Euro area, France, Germany
+33 1 42 14 72 88
alan.lemangnen@socgen.com

Simon RAY
Macro-finance analysis, UK
+33 1 4213 70 80
simon.ray@socgen.com

Valérie RIZK
Macro-sector analysis
+33 1 58 98 82 85
valerie.rizk@socgen.com

Danielle SCHWEISGUTH
Western Europe
+33 1 57 29 63 99
danielle.schweisguth@socgen.com

Edgardo TORIJA ZANE
Global economic forecasting
Middle East, Turkey and Central Asia
+33 1 42 14 92 87
edgardo.torija-zane@socgen.com

Bei XU
Asia
+33 1 58 98 23 14
bei.xu@socgen.com

Yolande NARJOU
Assistant
+33 1 42 14 83 29
yolande.narjou@socgen.com

Société Générale | SG Economics and Sector Studies | 75886 PARIS CEDEX 18

Subscribe to the Economic studies series:

https://www.societegenerale.com/en/news-and-media/economic-studies/our-economic-research

DISCLAIMER

This publication reflects the opinion of Societe Generale S. A.'s Economic and Sector Research department at the date of publication. This opinion is subject to change at any time without notice. It is provided for information purposes only, and does not constitute an investment recommendation or an investment advice within the meaning of current regulations. This publication has no contractual value.

Neither the information contained in, nor the analyses expressed therein constitute in any way an offer to sell or a solicitation to offer to subscribe, purchase, sell a product or execute a transaction and shall not engage the liability of Société Générale S. A. or any of its entities, in compliance with current regulations. Then, should a retail or a professional client, or eligible counterparty obtain this publication, they should not base any investment decisions solely on the basis of this publication, and must seek independent financial advice.

The accuracy, completeness or relevance of information derived from external sources is not warranted, even if it comes from sources reasonably believed to be reliable. Subject to the current regulations, Societe Generale S. A. does not accept any liability in this respect. The economic information mentioned in this document is based on data valid at a given time, and may therefore change at any time.

Societe Generale S. A. is a French credit institution authorized and supervised by the Autorité de Contrôle Prudentiel et de Resolution ("ACPR"), regulated by the Autorité des Marchés Financiers ("AMF") and under the prudential supervision of the European Central Bank ("ECB").

Societe Generale S.A. is also authorized by the Prudential Regulation Authority and subject to limited regulation by the Financial Conduct Authority and Prudential Regulation Authority. Details about the extent of our authorization and regulation by the Prudential Regulation Authority, and regulation by the Financial Conduct Authority are available from us on request.

Notice to US Investors: this document is issued by non-US SG economic analysts or affiliates on economic studies are issued solely to major US institutional investors pursuant to SEC Rule 15a-6. Any US person wishing to discuss this report or effect transactions should do so with or through SG Americas Securities, LLC. SG Americas Securities LLC has its registered office at 1221 Avenue of the Americas, New York, NY, 10020. (212) 278-6000.

Notice to Asian investors: this document is prepared for and intended to be distributed in Asia solely to sophisticated and professional clients. You should therefore be appropriately qualified as a professional, accredited, wholesale, expert or institutional investor (however defined in your local jurisdiction).

This publication may not in any way be reproduced (in whole or in part) or transmitted to any other person or entity without the prior written consent of Societe Generale SA.