

Appendix A**Economic Overview (November 2020) – Provided by Link Asset Services**

The global economic recovery has been hampered by the resurgence of COVID infections, which has resulted in the re-imposition of restrictive measures. However, the continued governmental support programmes have helped to minimise the impact on the working population. That said, a stimulus package in the US – at least initially - has been stymied by ongoing political deadlock. In Europe, the Brexit talks continue to make slow progress.

GDP will have faltered again during the latest lockdown and the introduction of the tier system will slow recovery in the short-term. However, with vaccinations, the restrictions should start to be relaxed, which will aid the recovery further down the line. Unemployment will still rise, but the peak is now expected to be less severe, and the enhanced prospects of economic recovery may also improve the outlook.

Q4 GDP is also likely to contract in the EZ but, again, vaccine developments offer light at the end of the tunnel. Containment measures are expected to be pared back once the most vulnerable have been inoculated. However, this may not be until Q2 2021 at the earliest, which would suggest a sharp economic bounce in Q2/3, with above trend growth sustained until the end of 2022. Despite this potential upside, the ECB remains cautious with further support expected to be announced in their December meeting.

With COVID infections surging across the US, some restrictions have been re-introduced, dampening activity levels. Weaker October retail sales reflect the impact and services activity indicators are indicative of further declines. This puts downside risks to Q4 growth projections, but the outlook for 2021 has changed with the developments on the vaccine front and the likelihood that a widely available vaccine over the next few months will add significant upside potential to economic growth. Add to that the increased likelihood of an additional fiscal stimulus package and, down the line, the US economy could be in a healthy position to drive to significant growth.

The Japanese economy is in the throes of a third wave of COVID, but restrictions have, so far, been limited. Accordingly, the impact on the economy will be nowhere near as severe as in Q2, if the second wave is anything to go by. If correct, private consumption should also not be damaged too greatly. The Government seems committed to keeping the economy open through this current surge, but if numbers reach levels that threaten the efficiency and effectiveness of the healthcare

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system, then a quick rethink may result. That downside risk is there, but the potential for a vaccine to be available in the short-term offers a better than previously expected outlook for the economy.

The concerns about bad debts, financial risks and property developers indicate that while improving, the Chinese economy has not yet returned to normal. The tolerance surrounding defaults has swung with changes in confidence in the economy and it looks likely that defaults may be close to a record high. The rise should not be a concern as credit risk, from which businesses have been protected through the pandemic, are necessary to drive corporate discipline. There are, however, concerns about some of the practices pertaining to the transfer of assets to related firms ahead of default, protecting them from creditors.

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Q4 is expected to see GDP contract by around 3.5% q/q, as the recovery was close to stalling by the close of Q3, with just a 1.1% m/m increase in September. At this point the economy was 8.2% shy of its pre-pandemic position. The tightening of restrictions in October and the month-long lockdown from November will weigh heavily on the economy and will result in a sharp November decline. The impact will not, though, be anywhere near as severe as the first lockdown, as only 20% of the economy was shut, and those exempt sectors will have continued to recover. Recent vaccine developments offer an improved outlook for the economy and analysts now believe it could regain pre-COVID levels in Q1 2022, but this is dependent on the Chancellor not being too quick out of the blocks in withdrawing fiscal support.

Consumer spending will be hit by the renewed lockdown and will probably ensure that it has fallen overall in Q4. Spending appears to have been resilient through October despite the regional differences in dealing with the spread of COVID. A 1.2% m/m growth pushed sales to 6.8% higher than back in February, with private car purchases surging. Eating out also picked up ahead of the signalled lockdown. November, though, is likely to see a contraction, despite online activity taking up some of the slack for goods demand. Services spending and closure of non-essential shops will hit overall spending levels. The Gfk measure of consumer confidence weakened slightly and remains only just above the low seen at the height of the pandemic in April. Households have continued to pay off credit and that should leave them in a strong position to spend once restrictions are removed. This, alongside vaccine developments, offer hope of a consumer spending bounce in 2021.

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The international trade surplus is likely to have been erased by Brexit and COVID and the deficit is forecast to grow as economic recovery takes off next year, while there is generally an uplift in deficits ahead of Brexit deadline days. Europe does appear to be engaging in some stock building, with increased export orders indicating a pick-up in volumes but, by the same token, there has been an increase in UK PMI stock balances, suggesting that similar activity is being undertaken here, which will see imports surge. Imports of household goods purchases may also rise due to COVID restrictions, which should see Chinese imports remain elevated for some time. However, there is a risk that much of this growth is the bringing forward of activity to avoid potential Brexit issues, which would suggest that both exports and imports will fall in early 2021. Down the line, successful vaccines will likely see imports increase faster than exports as the economy recovers, resulting in a greater deficit.

The peak of unemployment may not be as severe as feared with the COVID vaccine rollouts due to commence sooner than hoped. Analysts suggest that the peak may now be 7%, but that is still a sharp rise from the current 4.8%. The November lockdown has hit the services and entertainment sector, with furlough numbers spiking again, to around five million. However, this is only likely to push back the timing of job losses to May when the support scheme expires, and employment synchronises with the state of the economy. Forecasters see the decline in employment surging from 1.7% to 5%, or a loss of 1.6 million jobs. Vacancy levels are down 35% on pre-pandemic levels, which points to the increase in jobless numbers. Average earnings, having jumped in October, will fall back in November as furlough support equates to a 20% cut. However, as people leave the scheme there will be another jump in earnings, helped by a recovering economy. Economists see employment starting to rise again in Q3 2021.

With spare capacity in the economy set to rise, weaker inflationary pressures should ensure that inflation remains below 2% into 2022. Food and clothing inflation accounted for the October acceleration in CPI, and there are areas which have seen prices increased by the pandemic, such as second-hand car prices as travellers switch from public to private modes of transport. Meanwhile, reductions in supply caused by social distancing have also had an impact. The November lockdown and ongoing COVID restrictions should keep inflation sub-1% for the coming months, though goods' inflation could pick-up on a switch from services spending. April will, though, see inflation spike as the temporary VAT cut in the hospitality sector is reversed and the drag from the crash in the crude

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oil price drops out of the calculation. That could see inflation push to around 2% but spare capacity will pull that back.

Monetary Policy

Government's support for the global economy through the pandemic has continued and been increased/extended, though in the US the political wrangling has severely delayed the stimulus that the economy requires. Although the vaccine developments are a boost for sentiment it will take some months for the inoculation rollout to even dent the global population, so restrictions to some degree will be maintained. This means that support schemes are going to be required for some time yet, to ensure that the global economy continues to function. It is unlikely that there will be any marked shift in government or central bank fiscal/monetary stances in the short term, with the risk being that they act too quickly to pare back their commitments.

Source: City Watch December 2020 - Link Asset Services