

2020 Review & 2021 Outlook

Macroeconomics



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The Covid-19 pandemic brought about a synchronised global recession of historic proportions. On the other hand, unprecedented fiscal support measures cushioned the impact of the health crisis, while monetary policies also played a major role through swift and, in some cases, innovative actions that improved market liquidity and limited the increase in borrowing costs.

The global economic recovery is proving to be uneven, above all between the manufacturing and service sectors, and rarely in the past has there been such a significant gap to the detriment of the latter.

Indeed, the public response to slow the transmission of the virus, combined with changes in behaviour, has resulted in a sharp decline in activity for sectors that rely on social interaction, particularly retail, hotels, restaurants and entertainment.

Moreover, the divergence between China and the rest of the world - the “first in, first out” phenomenon - is striking. In Europe, a first wave hit the continent in March, then a second wave from October, which will result in a drop in GDP in Q4. In the United States, the Trump Administration’s chaotic management

of the health crisis will also leave its mark on economic activity. Conversely, the Chinese situation is continuing to improve.

However, the pessimism that the anticipated decline in GDP at year-end could have caused was overshadowed by the hopes raised following the discovery of a safe and effective vaccine. Research has indeed progressed at a record pace and some projects may soon be approved by the Public Health Authorities. While this is undeniably good news, the crisis will nonetheless leave scars that could cause significant damage to potential GDP growth in several countries.

Indeed, economic theory establishes a positive relationship between international trade and productivity, with an economy’s openness to trade

being associated with increased productivity gains. International trade is expected to contract by over -10% in 2020⁽¹⁾, a collapse similar to that seen in the 2009 Great Financial Crisis and is likely to exhibit subdued growth in the next few years, reflecting, in part, shifts in supply chains as firms re-shore production to reduce perceived vulnerabilities from reliance on foreign producers.

Furthermore, in the years leading up to the pandemic, relatively weak business investment growth and more modest gains in human capital improvements were factors that undermined productivity in several economies. To maintain access to credit, unprecedented and timely policy response has recently been put in place. Taking advantage of the massive easing in financial conditions, businesses have stepped up their bond issuance and increased their borrowing from banks to cope with cash shortages and build precautionary cash buffers. However, this further increase in private sector indebtedness adds to already extremely high levels of debt, which could lead to a decline in productivity through a reduction in firms' ability to invest.

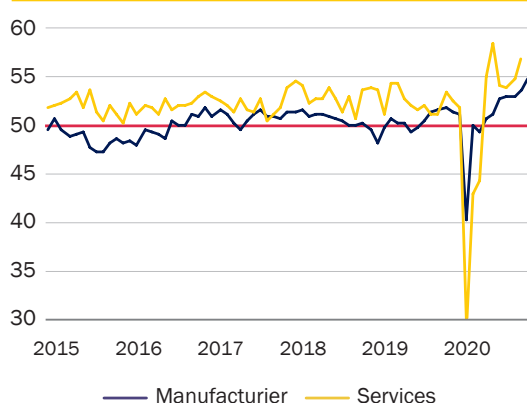
Public debt has also soared in recent months and could reach a historic level of 100% of GDP in 2020⁽²⁾. Although the prospect of low interest rates over a long period of time could help ease the debt burden, government debt is a major challenge, especially if the decline in potential growth implies a reduction in the tax base, which could complicate the servicing of public debt.

Meanwhile, inequalities are expected to increase as the economic crisis has disproportionately affected the work of young people, women, and individuals with relatively low levels of education. The closure of schools poses an additional challenge that can seriously affect the accumulation of human capital.

In short, despite potential stumbling blocks at year-end, the path to economic recovery is becoming clear due to the responsiveness of the public authorities and the hard work of scientists. Beyond its obvious economic impact, however, the health crisis could have persistent socio-economic impacts, weakening long-term growth prospects. ■

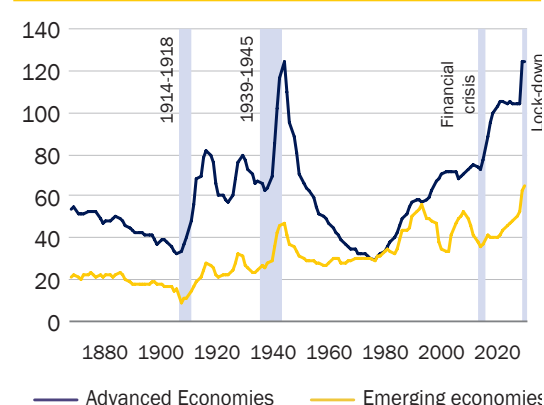
To be completed by 23 November 2020.

China - Confidence Index Markit



Sources: Macrobond, Rothschild & Co Asset Management Europe, Novembre 2020.

World - Public Debt



Sources: FMI, Rothschild & Co Asset Management Europe, Novembre 2020.

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