CANDRIAM

A NEW YORK LIFE INVESTMENTS COMPANY

ECONOMIC AND FINANCIAL OUTLOOK

October 2020

Global Cases

27,105,151

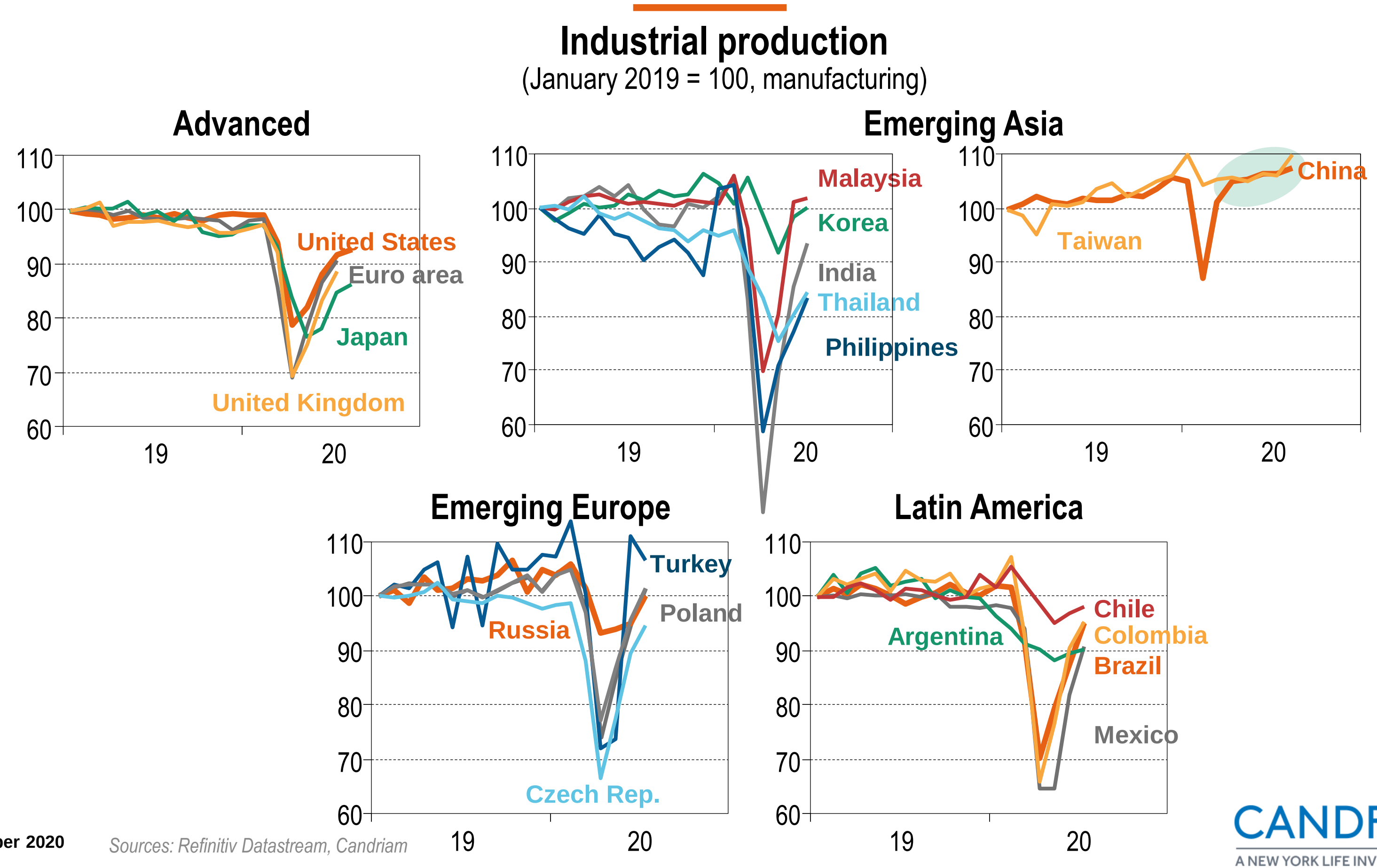
Cases by Country/Region/Sovereignty

6,276,421	US
4,204,613	India
4,137,521	Brazil
1,022,228	Russia
683,702	Peru
666,521	Colombia
638,517	South Africa
634,023	Mexico
498,989	Spain
478,792	Argentina
422,510	Chile
386,658	Iran
349,500	United Kingdom
347,268	France
325,157	Bangladesh
320,688	Saudi Arabia
298,903	Pakistan
279,806	Turkey
277,634	Italy

1. GLOBAL ECONOMY
An unprecedented contraction

https://gisanddata.maps.arcgis.com/apps/opsdashboard/index.html#/bda7594740fd40299423467b48e9ecf6

Industrial production has contracted sharply



Sources: Refinitiv Datastream, Candriam

A job applicant makes a call at an on-site job fair in Wuhan last month. The landscape for job hunters might get even more difficult in the coming weeks as about 8.7 million people graduate from colleges and universities.

Source: CNN

2. China
Relying on its own strength

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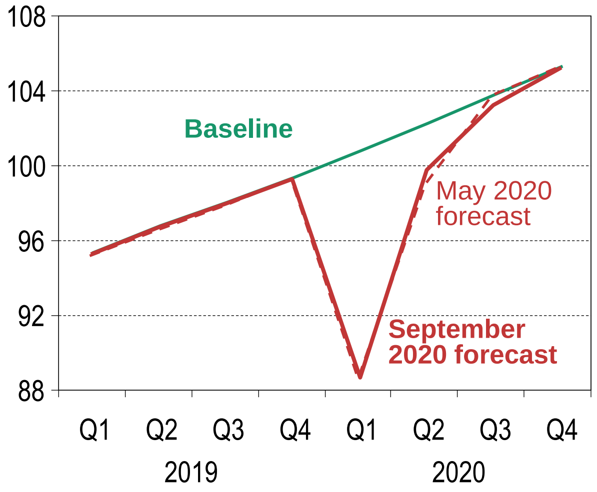
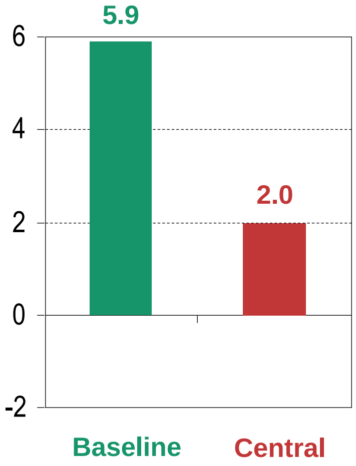
If the epidemic remains under control, GDP should be back to its previous trend by the end of 2020

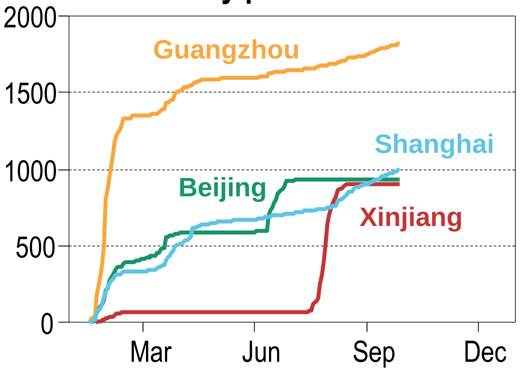
GDP trajectory
(January 2020 = 100)



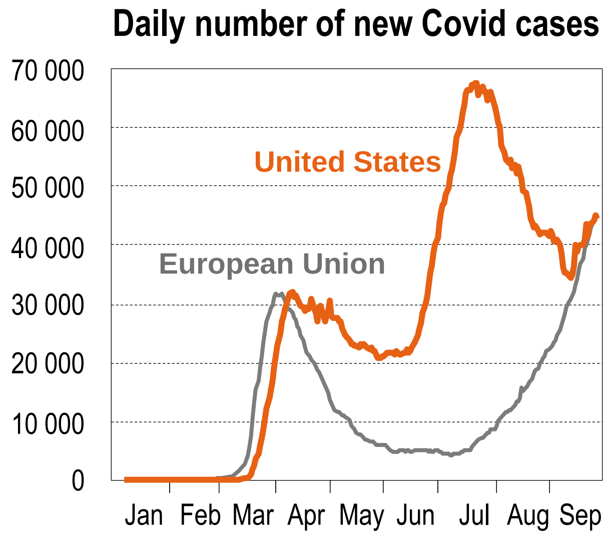
GDP growth in 2020
(%, annual average)



Memo: cumulative number of Covid cases by province in 2020



Sources: Refinitiv Datastream, Bloomberg, Candriam



Source: Refinitiv Datastream

3.1 United States
The recovery goes on

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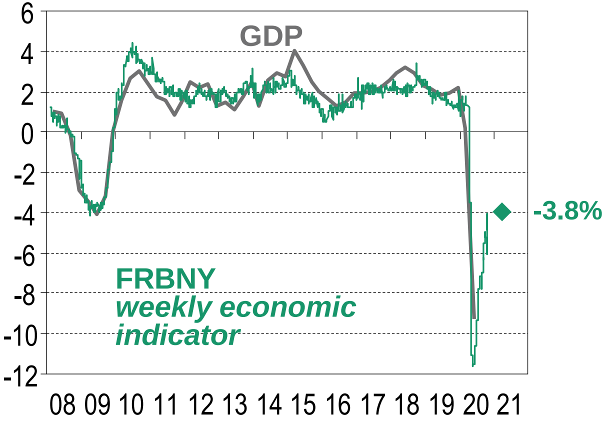
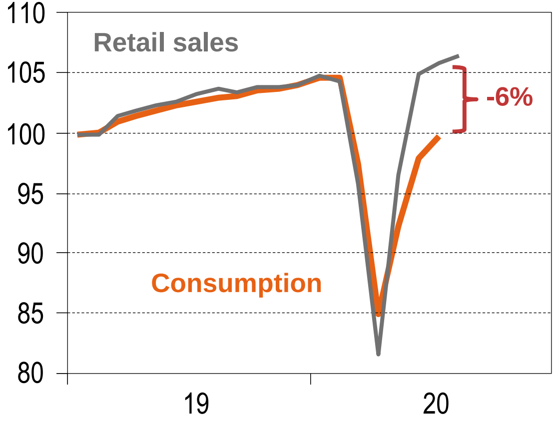
A pick-up in activity is clearly underway

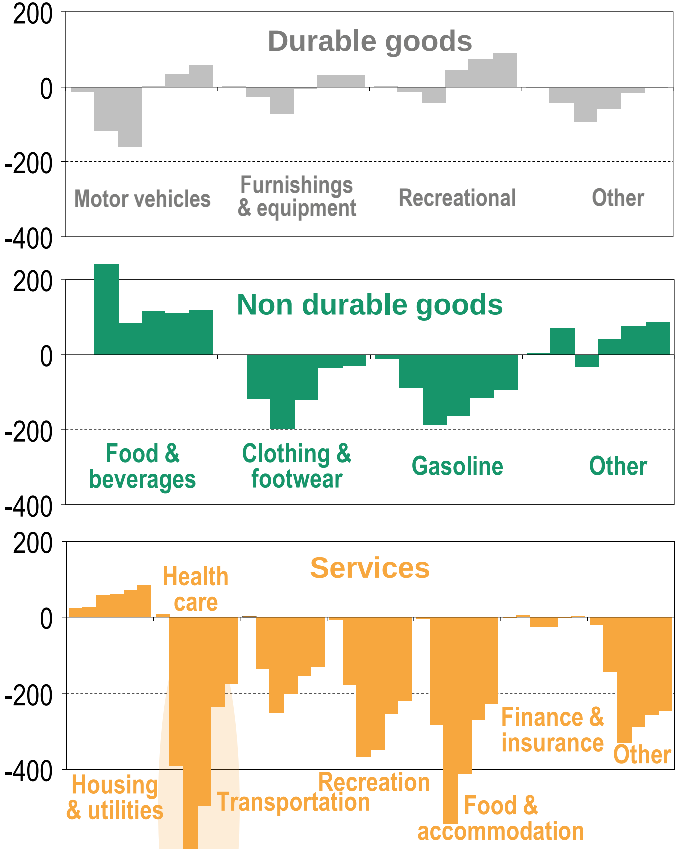
Weekly economic indicator
(% year on year)



Consumption and retail sales
(January 2019 = 100, nominal)

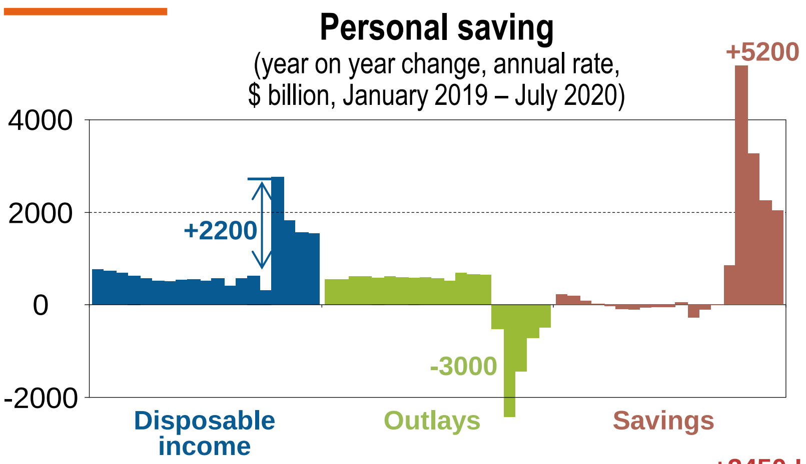


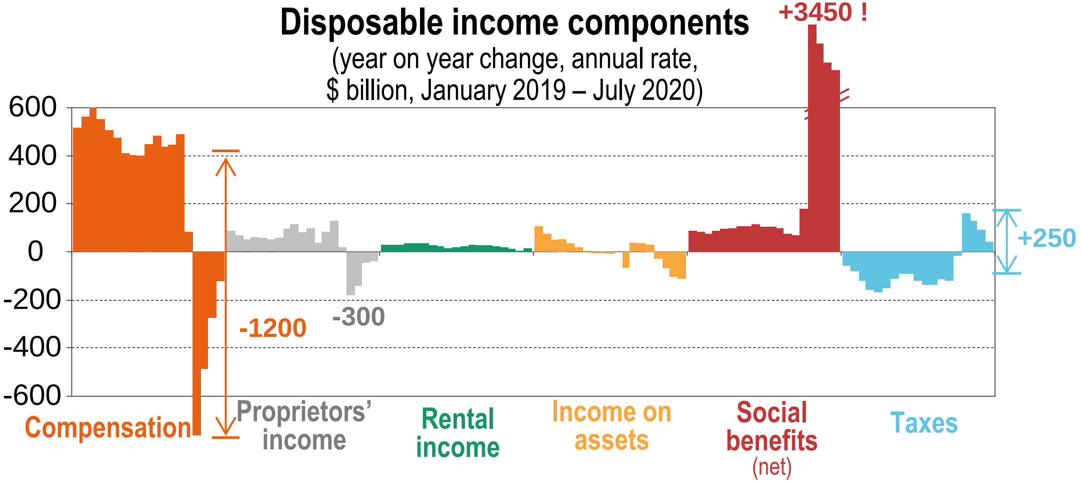
Consumption spending
(year on year change since February 2020, $ billion,
February 2020 – July 2020)



Sources: Apple mobility, Candriam

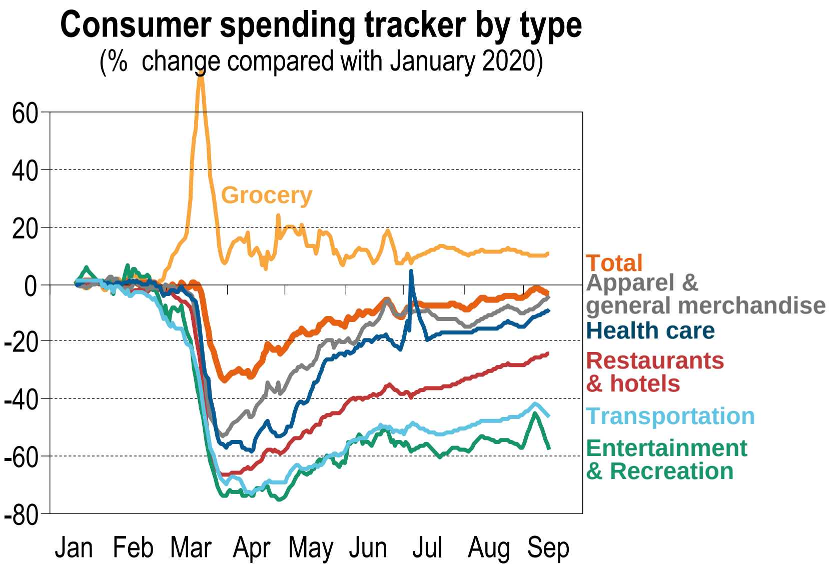
The household saving rate is however still well above its pre-crisis level

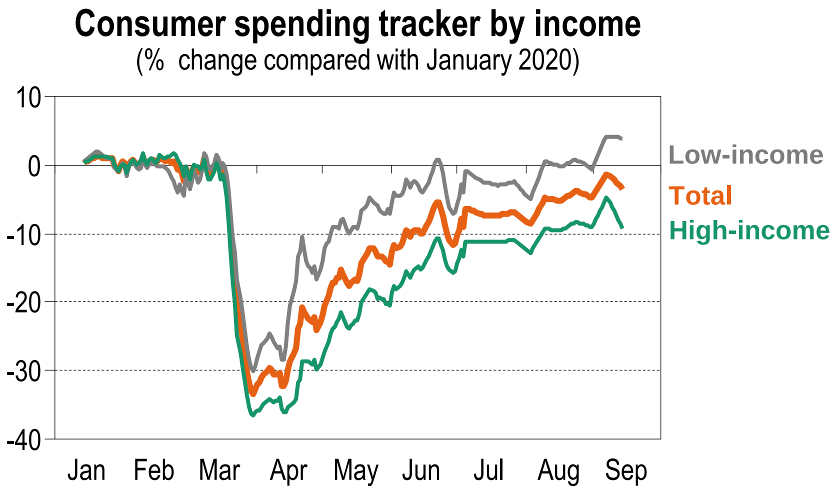


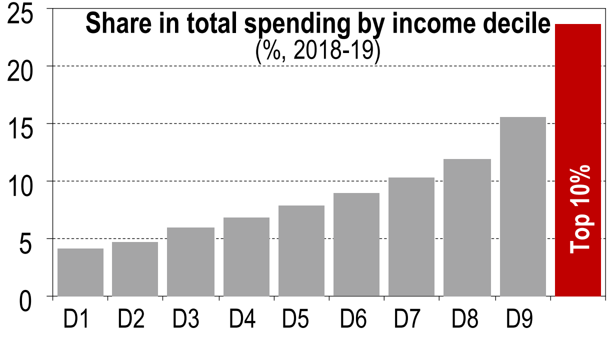


Sources: BEA, Refinitiv Datastream, Candriam

Social distancing continues to curb high income earners' consumption



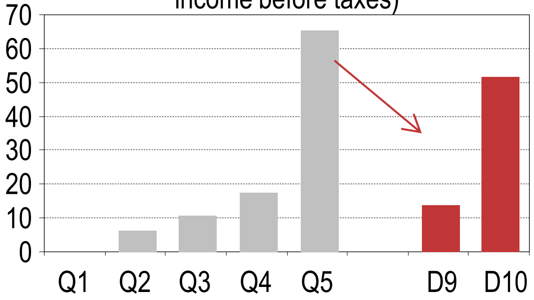




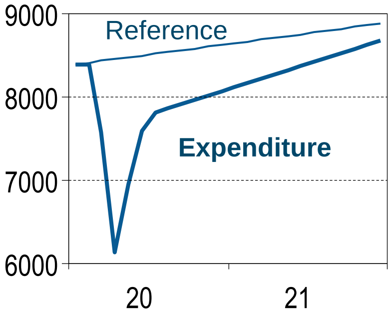
Sources: Refinitiv Datastream, Track the recovery, Candriam

The return of consumption to “normal” will depend on the spending behavior of high income earners… and on access to consumer credit for the rest of US households

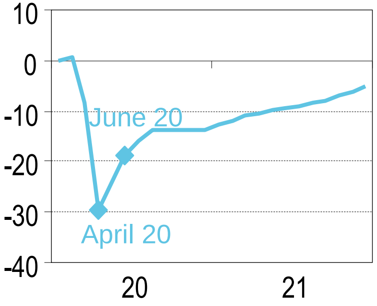
Shares in income per quintile
(%, 2016, *Survey of Consumer Finance*, income before taxes)



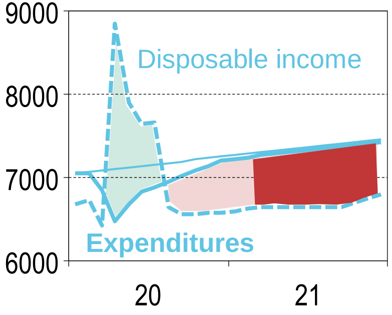
Consumption of the 5th quintile
(billion dollars)



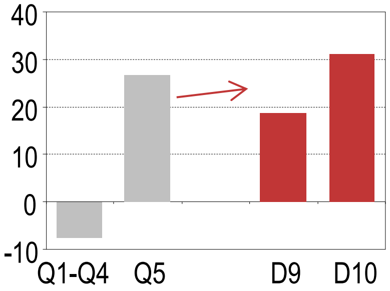
Wage bill of quintiles 1 to 4
(%, against the reference)



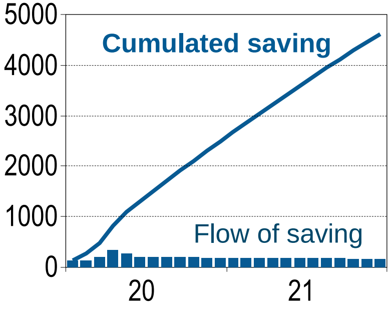
Consumption of quintiles 1 to 4
(billion dollars)



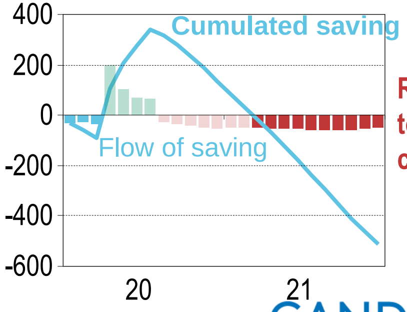
Saving rate per decile
(%, 2018, *Consumer Expenditure Survey*)



Saving of the 5th quintile
(billion dollars)



Saving of quintiles 1 to 4
(billion dollars)

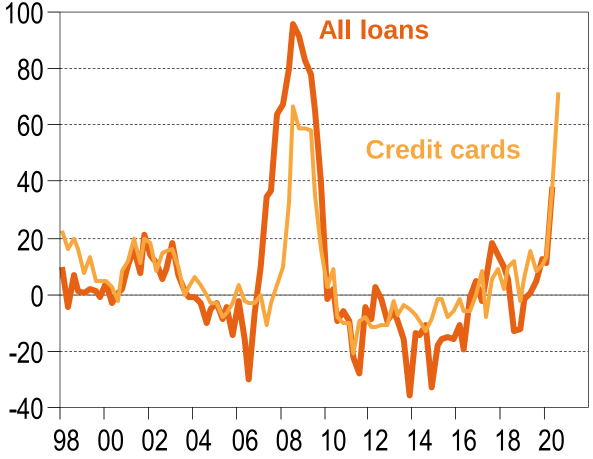


Requires households to have access to consumer credit

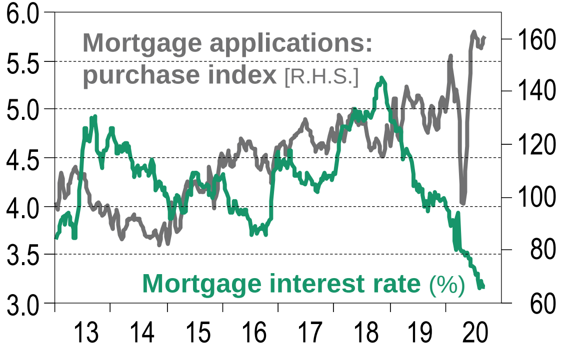
Sources: BEA, Candriam

Unfortunately banks have tightened their lending conditions for consumer credit while lower rates are supporting mortgage borrowing by high credit score households

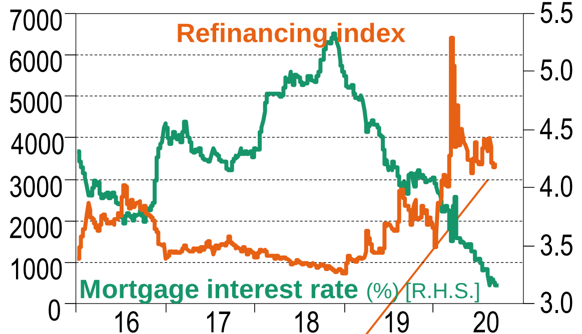
Banks credit standards
(Loan officer survey, %)



Mortgage applications for house purchase

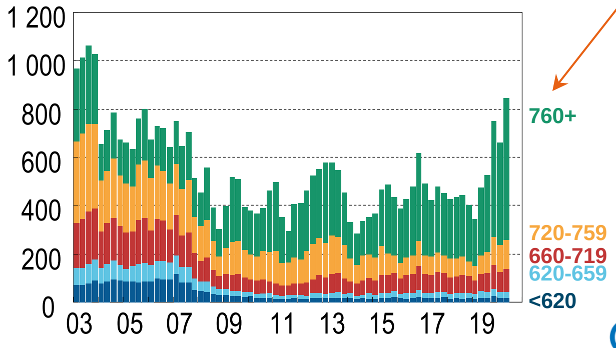


Mortgage refinancing



Refinancing mainly concerned borrowers with high credit scores.

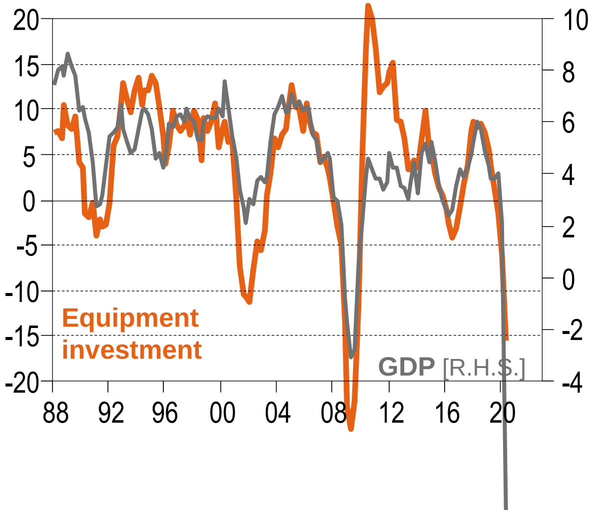
Mortgage origination by credit score



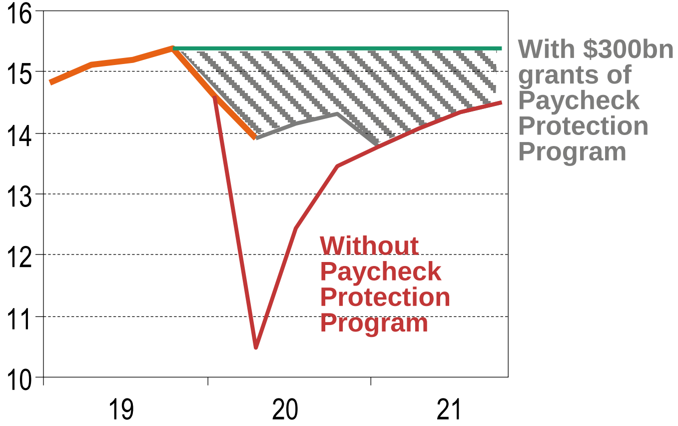
Sources: BEA, Refinitiv Datastream, Candriam

The Paycheck Protection Program (PPP) has lowered the risk of a deep contraction in business investment

Equipment investment
(% year on year, nominal)



Nonfinancial corporate business gross operating surplus
(% of 2019 GDP)



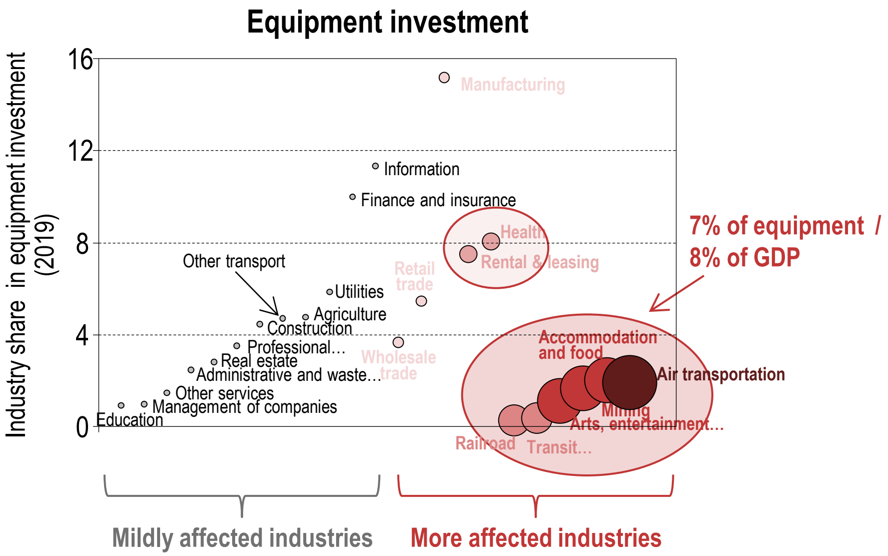
2020 loss in gross operating surplus

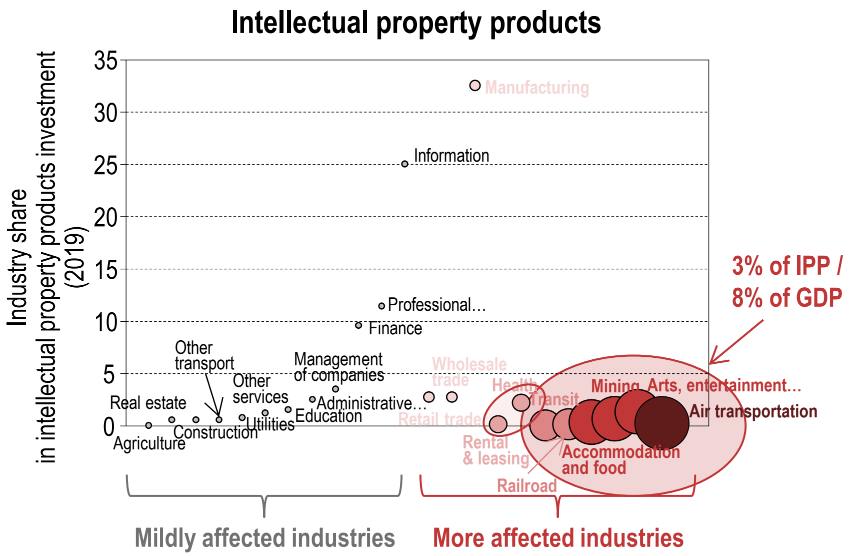
	Without PPP	With PPP
% of 2019 GDP	-2.7%	-1.1%
% of 2019 gross investment	**-28%**	**-12%**

Sources: BEA, Refinitiv Datastream, Candriam

Moreover, the sectors most affected are not those that invest the most: their share of investment in intellectual property products in particular is rather low

Industry share in investment and shock size by industry*





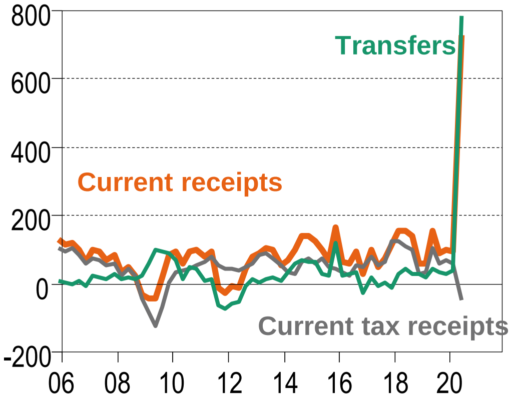
(*) Bubble size is proportional to each industry' shock in 2020

N.B. Adding health and rental & leasing, the most affected industries would weigh 23% in equipment investment, 5% in intellectual property products and 18% of GDP.

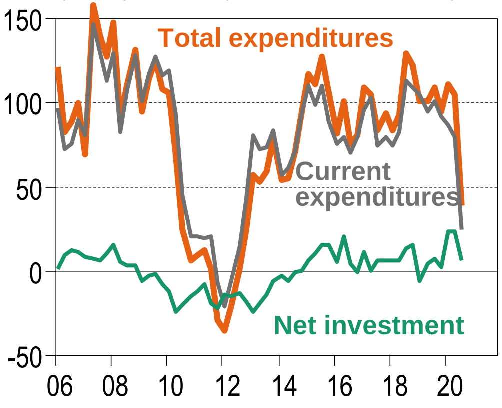
Sources: BEA, Refinitiv Datastream, Candriam

While the CARES Act federal transfers boosted state and local governments' receipts in Q2, many S&L governments are now in a difficult financial position

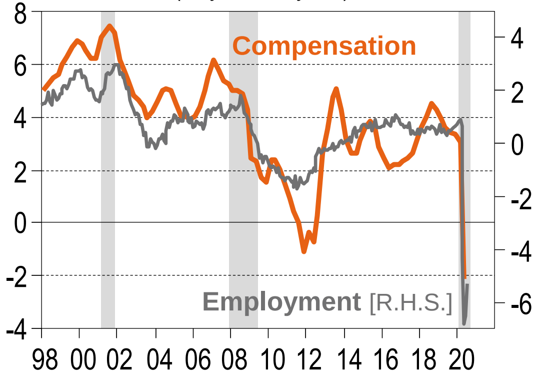
State and local government receipts
(change over 1 year, billions of dollar)



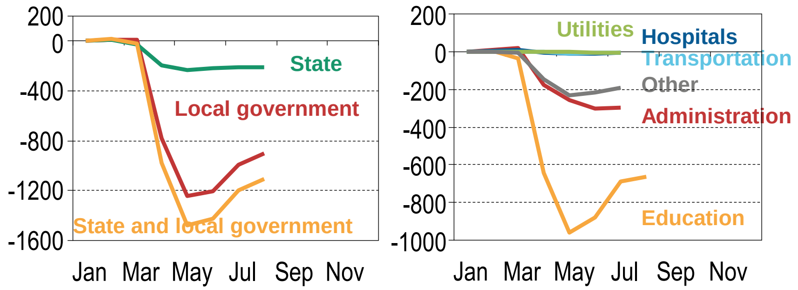
State and local government expenditure
(change over 1 year, billions of dollar)



State and local government compensation and employment
(% year on year)



State and local government employment
(cumulated change since January 2020, thousands)

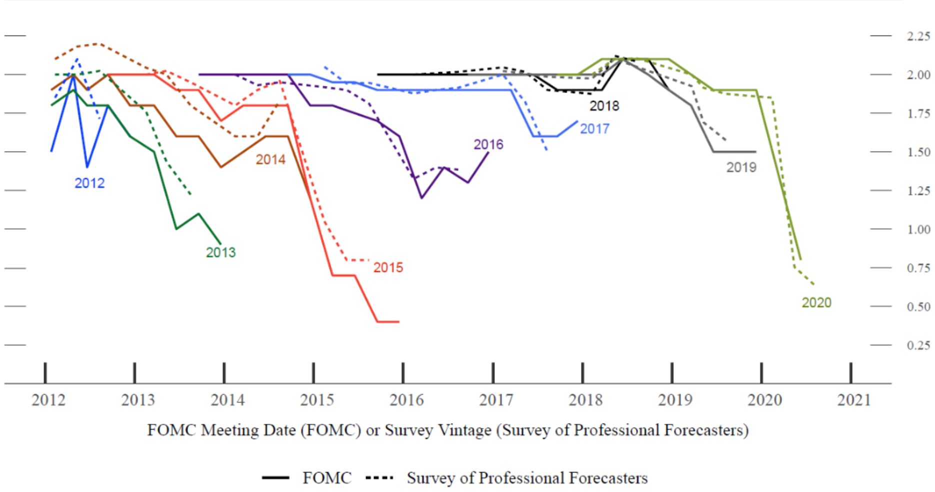


Sources: Refinitiv Datastream, Candriam

In the short term, the change in the Federal Reserve's inflation target will lead to a more accommodative policy

Over the years, forecasts from FOMC participants and private-sector analysts routinely showed a return to 2% inflation, but these forecasts were never realized on a sustained basis.

Change in consumption deflator projections (%)



Our longer-run goal continues to be an inflation rate of 2 percent. Our statement emphasizes that our actions to achieve both sides of our dual mandate will be most effective if longer-term inflation expectations remain well anchored at 2 percent. However, if inflation runs below 2 percent following economic downturns but never moves above 2 percent even when the economy is strong, then, over time, inflation will average less than 2 percent.

Therefore, **following periods when inflation has been running below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time.**

Jerome Powell, New Economic Challenges and the Fed's Monetary Policy Review, August 27, 2020

Sources: Federal reserve, Candriam

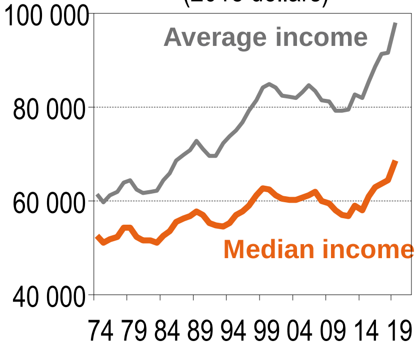
In the longer term, the change in the Fed full employment target could make monetary policy more discretionary

The characterization of our **maximum employment goal as broad-based and inclusive** clarifies that the Federal Reserve **seeks to foster economic conditions that benefit everyone**. It also stresses the importance of understanding **how various communities are experiencing the labor market** when assessing the degree to which employment in the economy as a whole is **falling short of its maximum level**.

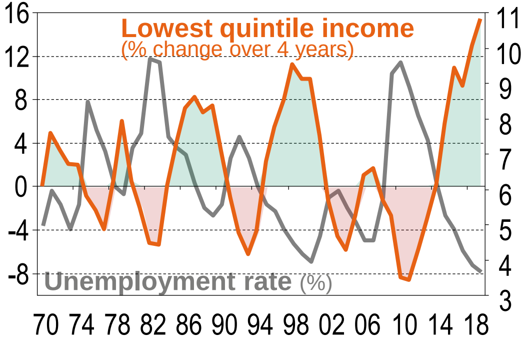
The Committee considers a wide range of indicators in making these assessments.

Federal reserve, Review of Monetary Policy Strategy, Tools, and Communications.

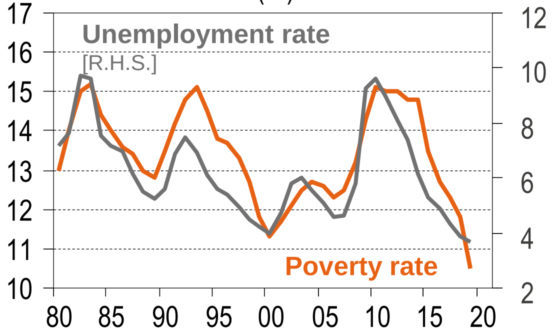
Average and median real household income
(2018 dollars)



Lowest quintile income and unemployment



Poverty rate and unemployment
(%)



Sources: BEA, Refinitiv Datastream, Candriam

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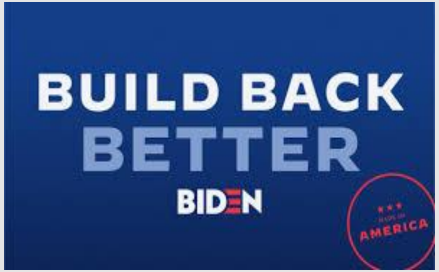


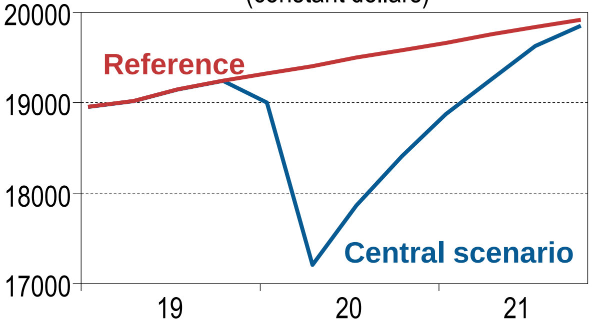
3.2 United States
On a tight rope…

Despite political and health uncertainties, our central scenario still assumes a return of the economy to its long-term trend by the end of 2021

	GDP growth 2020	GDP growth 2021	Cumulated GDP loss* over 2020-21
Central scenario	-5.1	7.0	4.4

(*) Loss compared to the baseline

GDP level
(constant dollars)



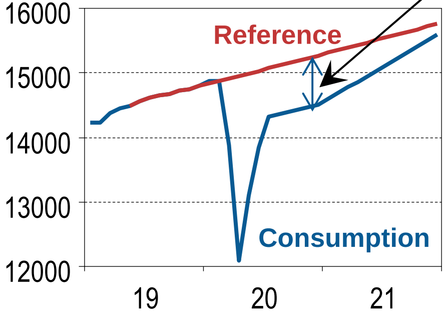
Impact on GDP level in 2020
(% against the baseline)

	March	April	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
Central scenario	-5	-14	-11	-9	-9	-8	-8	-7	-6	-5

Central scenario assumptions

Consumption
(constant dollars)

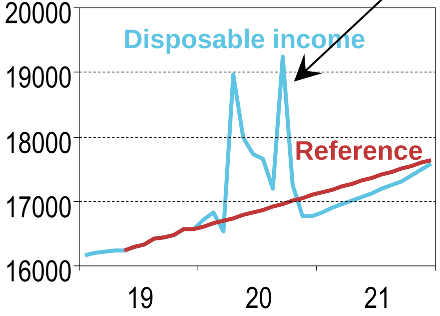
Marked reduction in social distancing at the end of 2021.



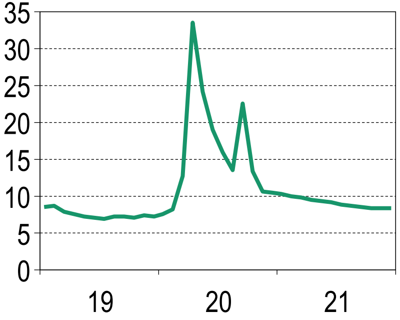
Our central scenario assumes moderate additional budget support and a marked reduction in distancing at the end of 2021.

Additional fiscal support

Disposable income
(constant dollars)



Saving rate
(% of disposable income)



 Source: Candriam

By end of September, it seemed rather unlikely that the future President will have a large majority in Congress, allowing him to implement quickly its program

President	Congress	Economy in 2021
Joe Biden — Large majority	Democrat majority	Central scenario trajectory, or even a little above
Joe Biden	Republican Senate	Despite a possible guerilla warfare in Congress, the economy could more or less be on our central scenario trajectory.
Donald Trump	Democrat House	
Donald Trump — Large majority	Republican majority	Central scenario trajectory or a little below if the Republicans become more fiscally conservative.

The main risk is that of an election whose result would be contested either by the losing party or by the population.

The resulting political and social instability would hamper activity.

"We built a series of war games […] **A landslide for Joe Biden resulted in a relatively orderly transfer of power. Every other scenario we looked at involved street-level violence and political crisis**."

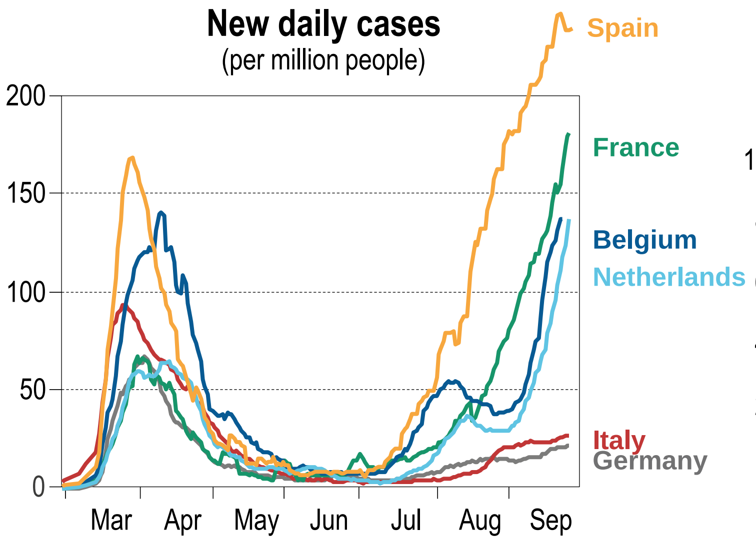
In What's the worst that could happen? Rosa Brooks, Washington Post, September 3 2020.

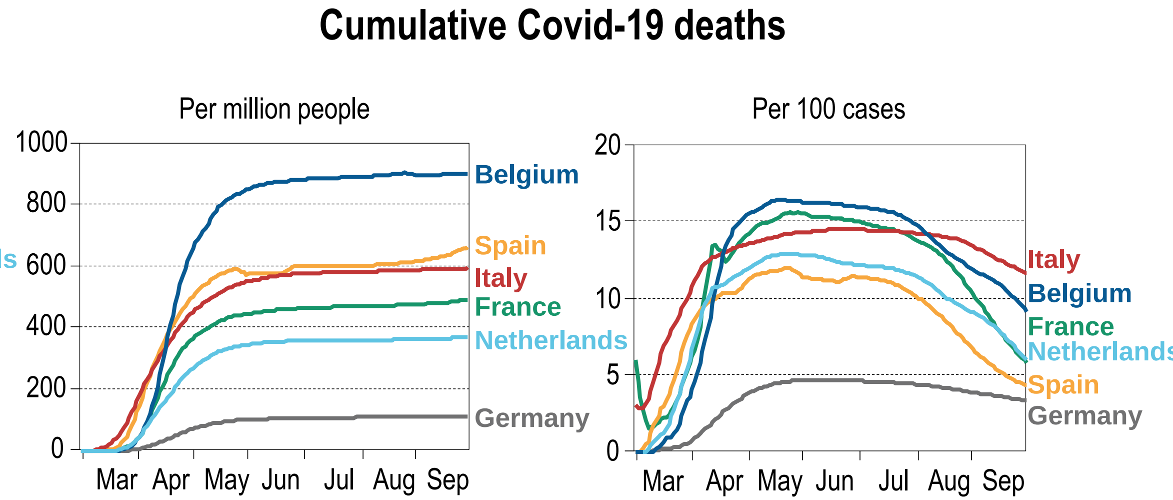
Source: Candriam

Germany takes over
EU presidency

4. Euro area
Activity recovers… unevenly!

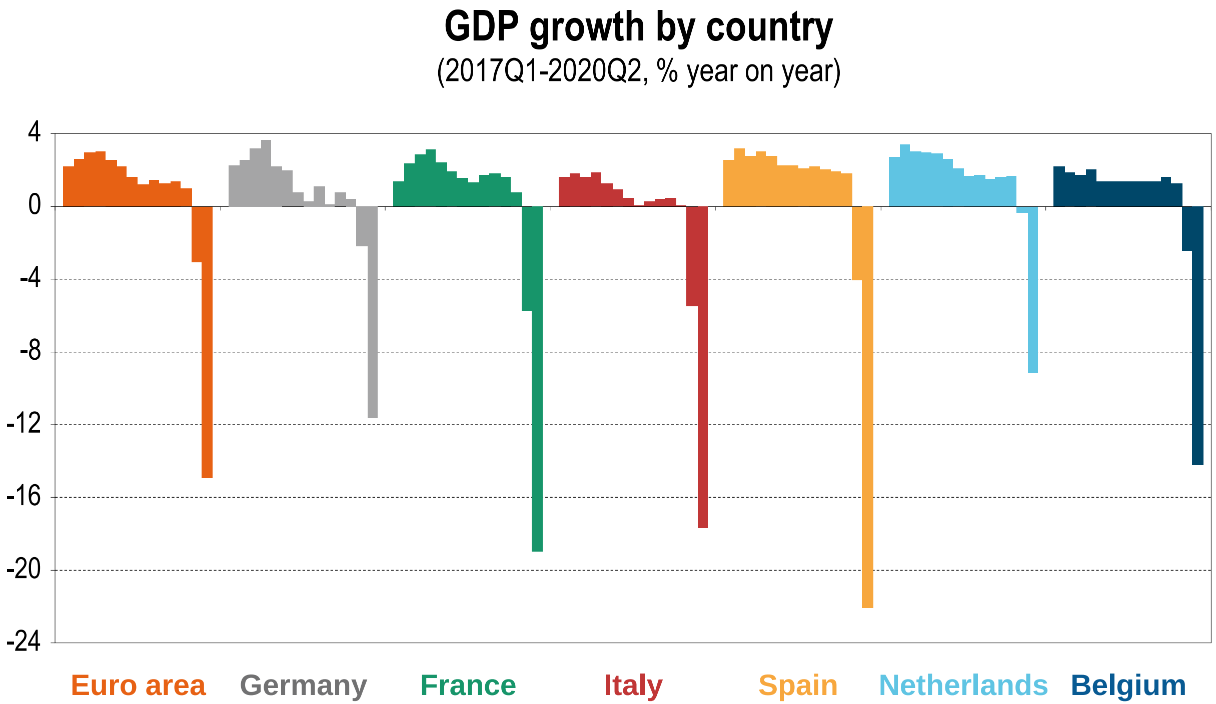
In some countries, the epidemic seems about to run out of control





Sources: Refinitiv Datastream, Candriam

During the second quarter, the fall in activity was spectacular



October 2020

Sources: Refinitiv Datastream, Candriam

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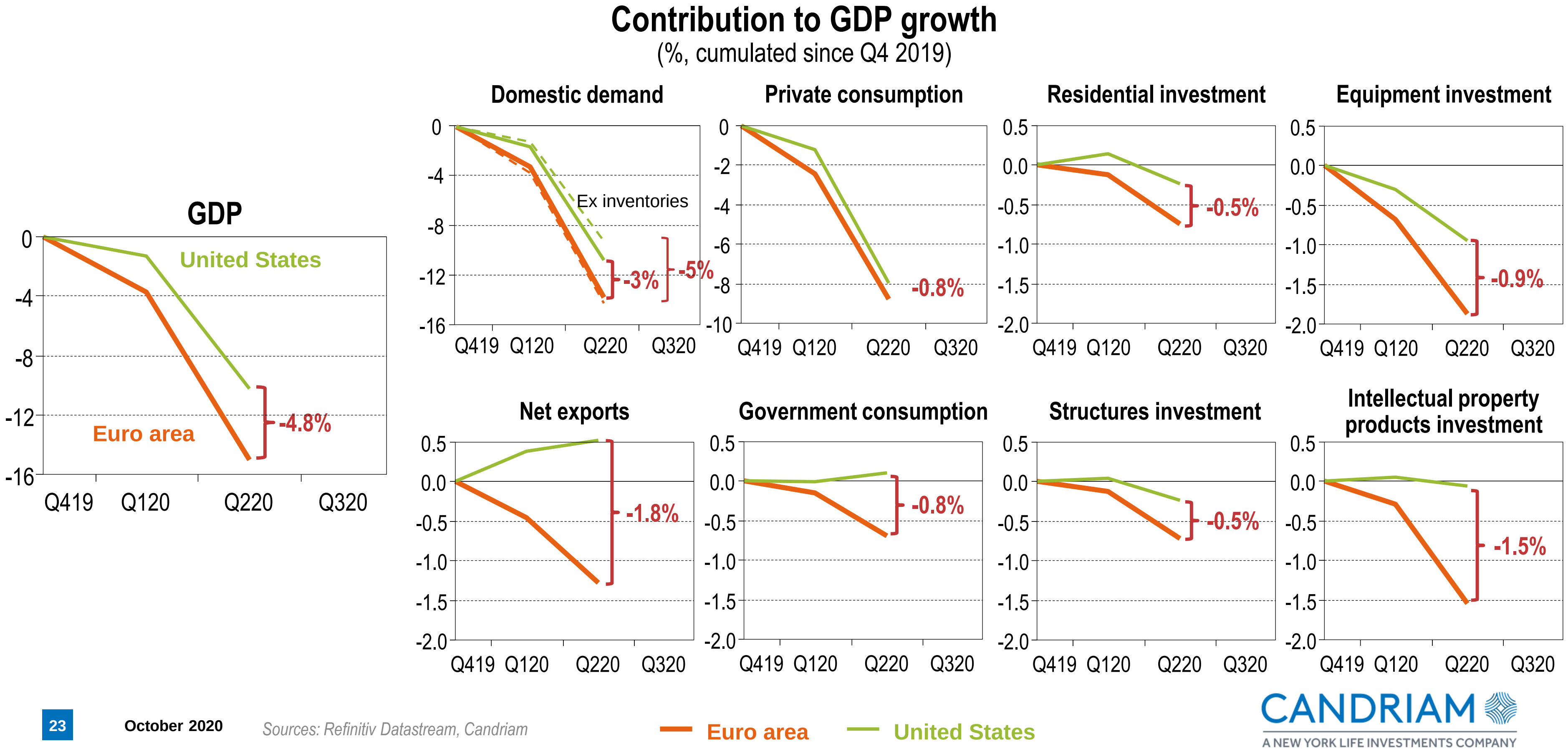
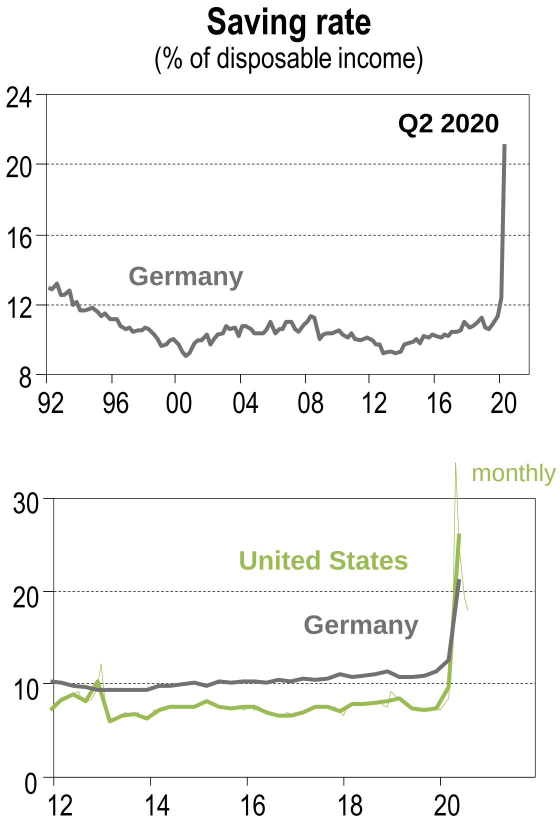
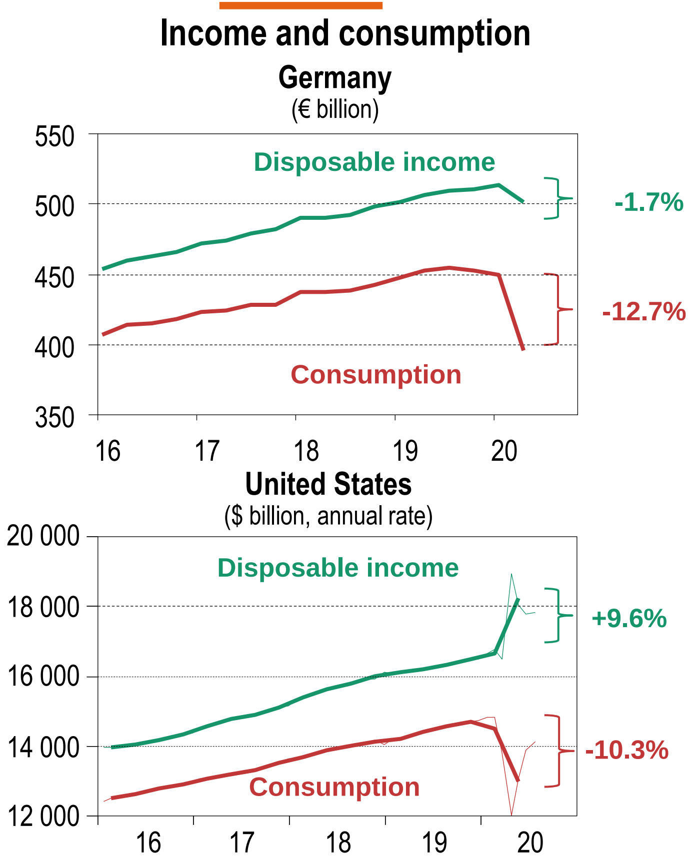
The fall in investment was deeper than in the United States

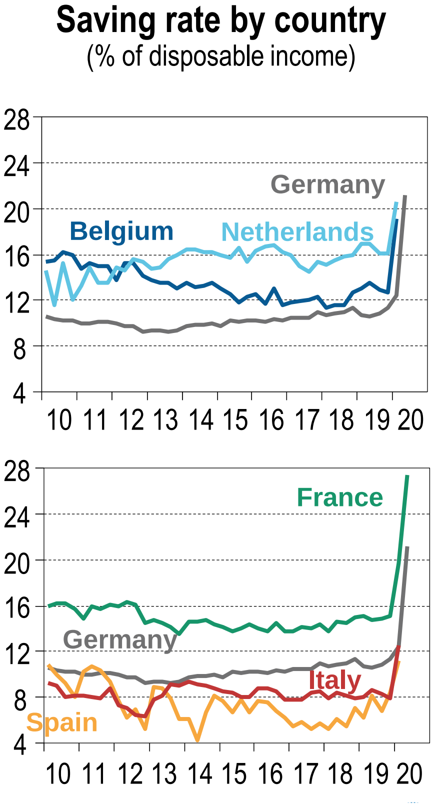


October 2020
Sources: Refinitiv Datastream, Candriam

Like in the United States, the household saving rate rose, but the magnitude and the reasons of the increase were somewhat different



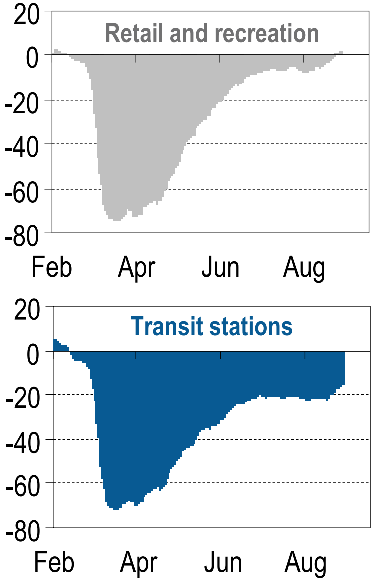




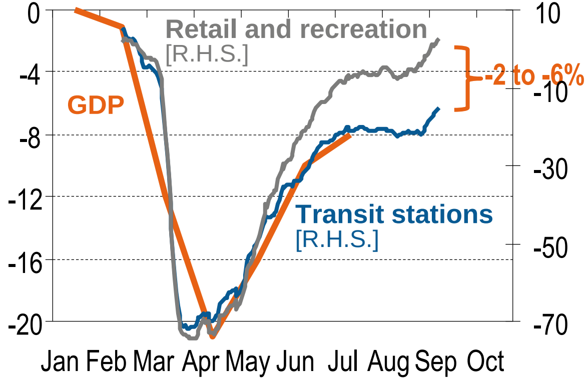
Sources: Refinitiv Datastream, Candriam

Google's real-time data suggests that euro zone GDP was about 4% below the reference trend in September

Google mobility trend in the euro area
(% compared to January 2020, moving average over 7 days)

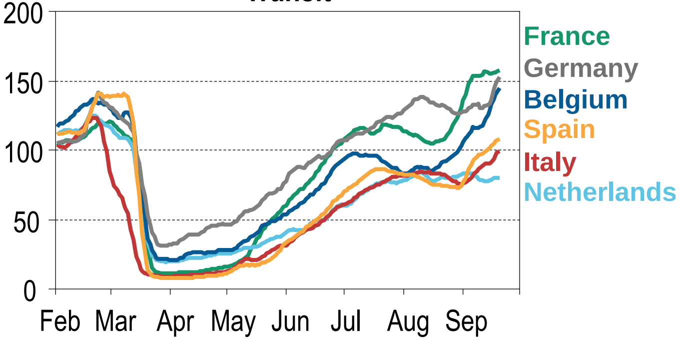


GDP compared to pre-Covid trend
(%)

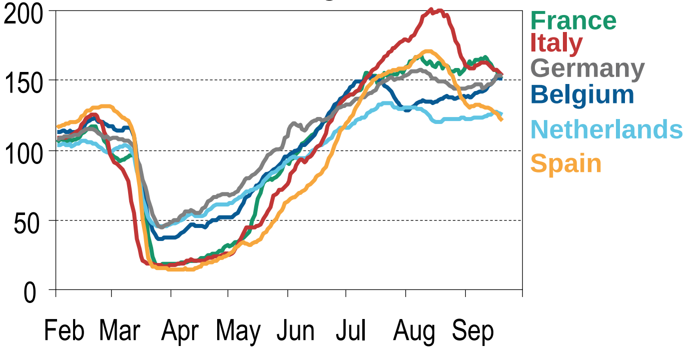


Apple mobility trend
(February = 100, moving average over 7 days)

Transit



Driving

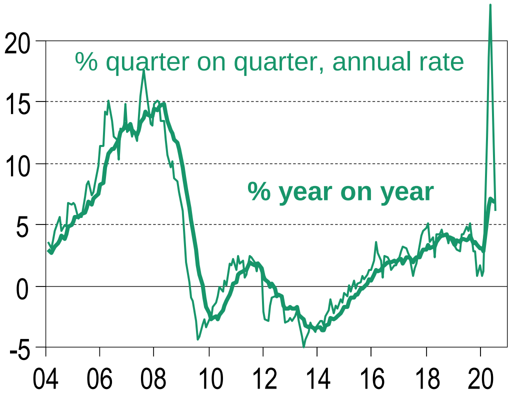


(*) Based on the 8 largest euro area countries.
Transit stations: mobility trends for places like public transport hubs such as subway, bus, and train stations;
Retail & recreation: mobility trends for places like restaurants, cafes, shopping centers, theme parks, museums, libraries, and movie theaters

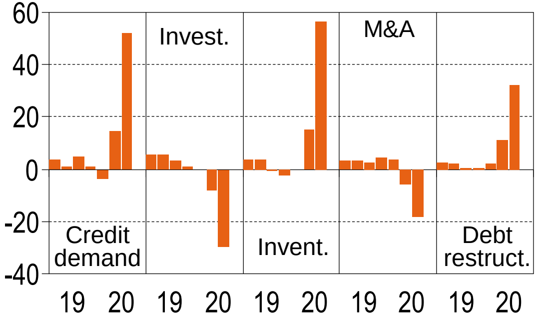
Sources: Refinitiv Datastream, Candriam

State guarantees have given firms access to credit, but French and Spanish banks are now expected to tighten their credit standards

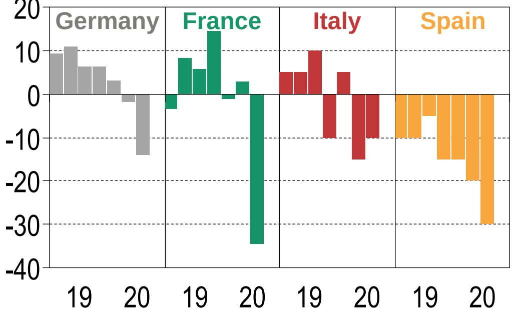
Loans to nonfinancial corporations



Reason for nonfinancial corporations' credit demand in the euro area



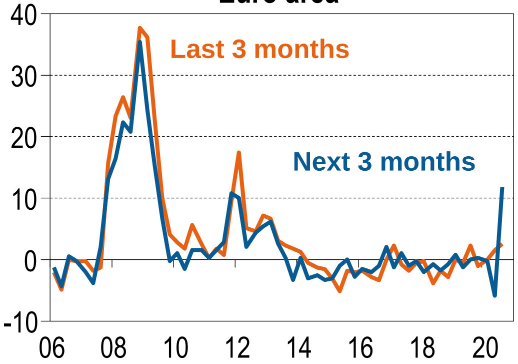
Credit demand for investment by country



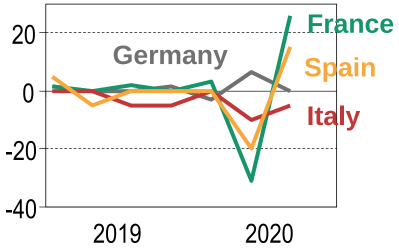
Credit standards for nonfinancial corporations

(%, diffusion index)

Euro area



Credit standards over the next 3 months

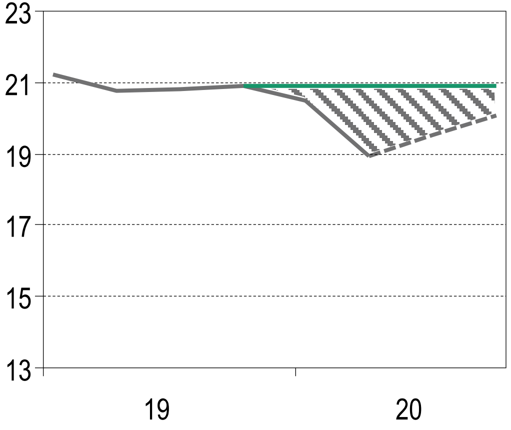


Sources: Refinitiv Datastream, Candriam

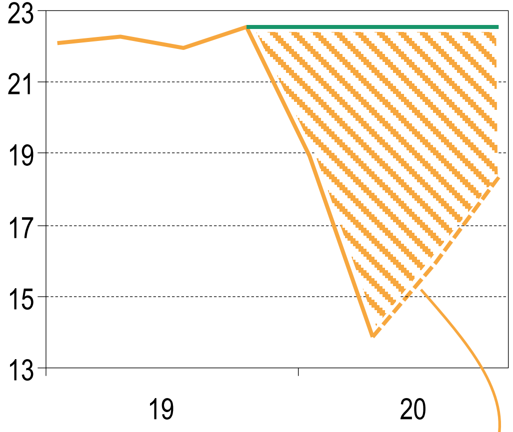
Without additional support, it may be hard for business investment to fully recover... in Spain in particular!

Nonfinancial corporations' gross operating surplus
(% of 2019 GDP)

Germany



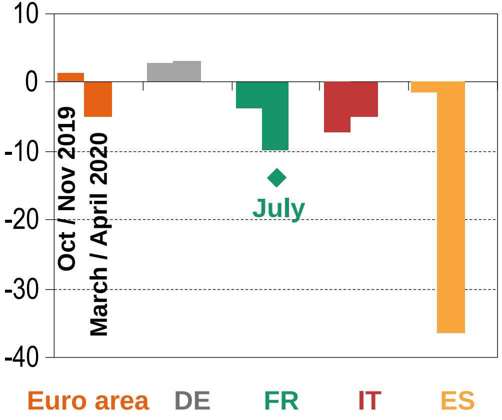
Spain



2020 loss in gross operating surplus

	Germany	Spain
% of 2019 GDP	-1.2%	-5.8%
% of 2019 gross investment	**-10%**	**-40%**

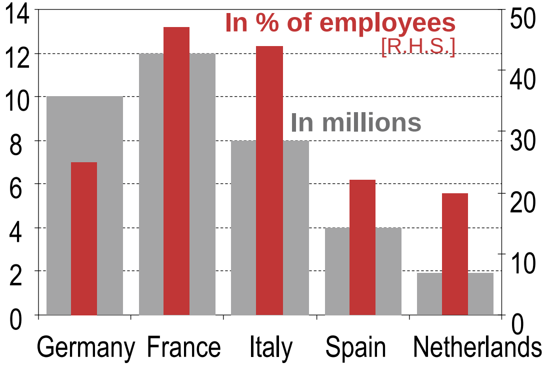
Industry survey: investment intentions
(%, expected growth in 2020, volume)



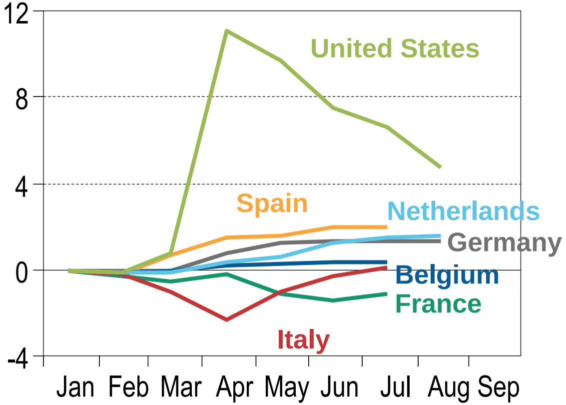
Sources: Refinitiv Datastream, Candriam

Short-time working schemes have prevented an excessive rise in unemployment rates and have greatly mitigated households income losses

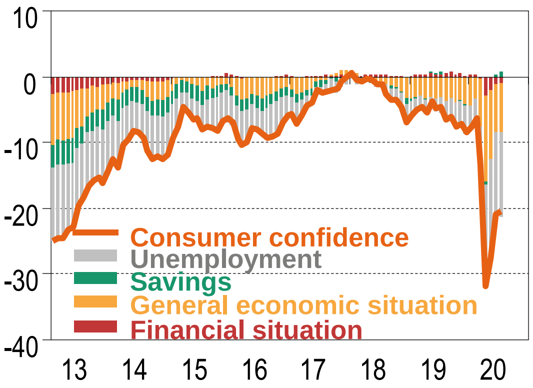
Employees in short-time work schemes
(up to mid-May 2020)

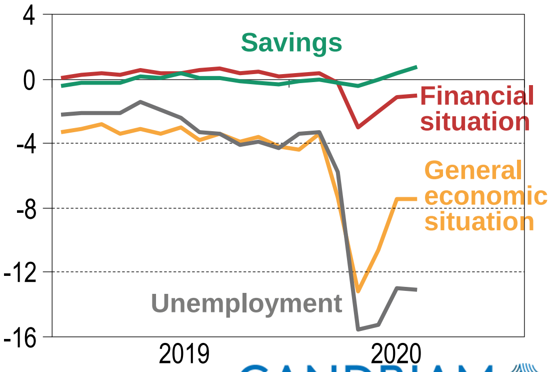


Change in unemployment rate
(% since January 2020)



Consumer confidence

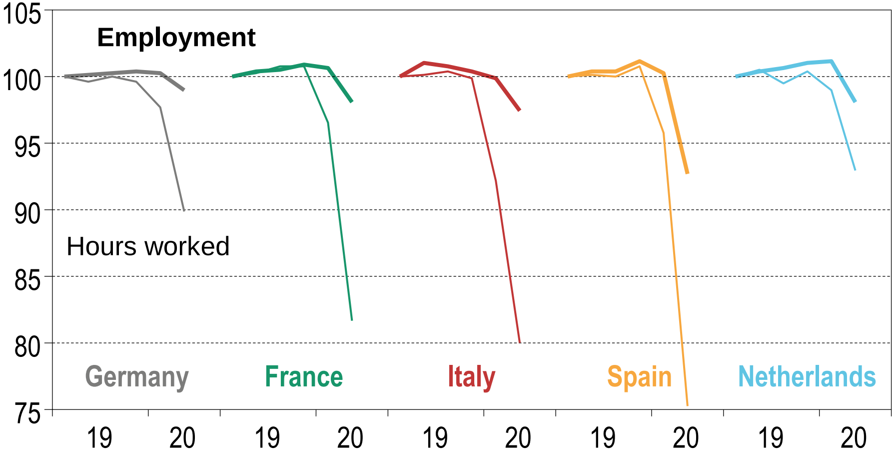




Sources: Refinitiv Datastream, Candriam

In some countries, though, the decline in hours worked has been particularly deep…

Employment and hours worked
(2019 Q1 = 100)

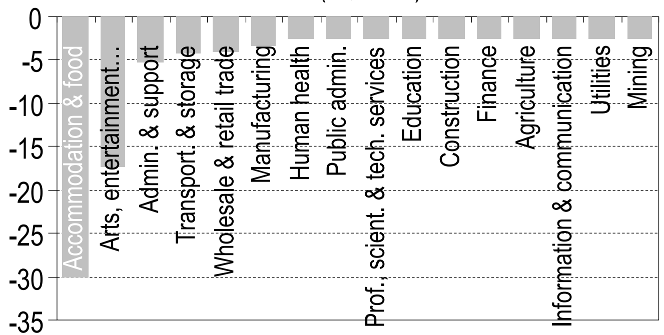


In Germany, the government has just extended the short-time working scheme set up during the crisis until the end of 2021.
In Italy and France, a long-term (two-year) short-time working scheme has been decided (in the case of France, companies cannot reduce hours by more than 40%).
Spain has not yet extended its ERTE scheme, which is due to end at the end of September.

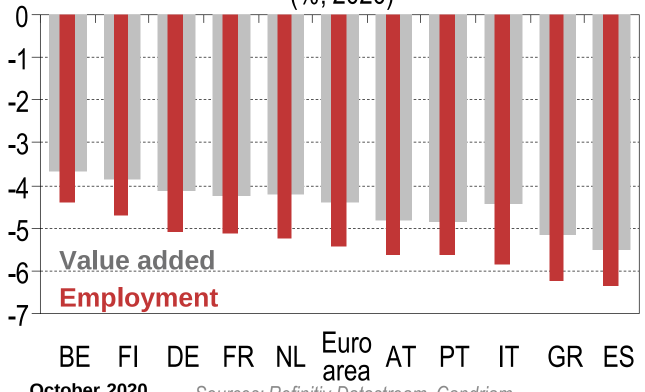
 Sources: Refinitiv Datastream, Candriam

… and by the end of the year, job losses are likely to be severe in Spain and probably in Italy

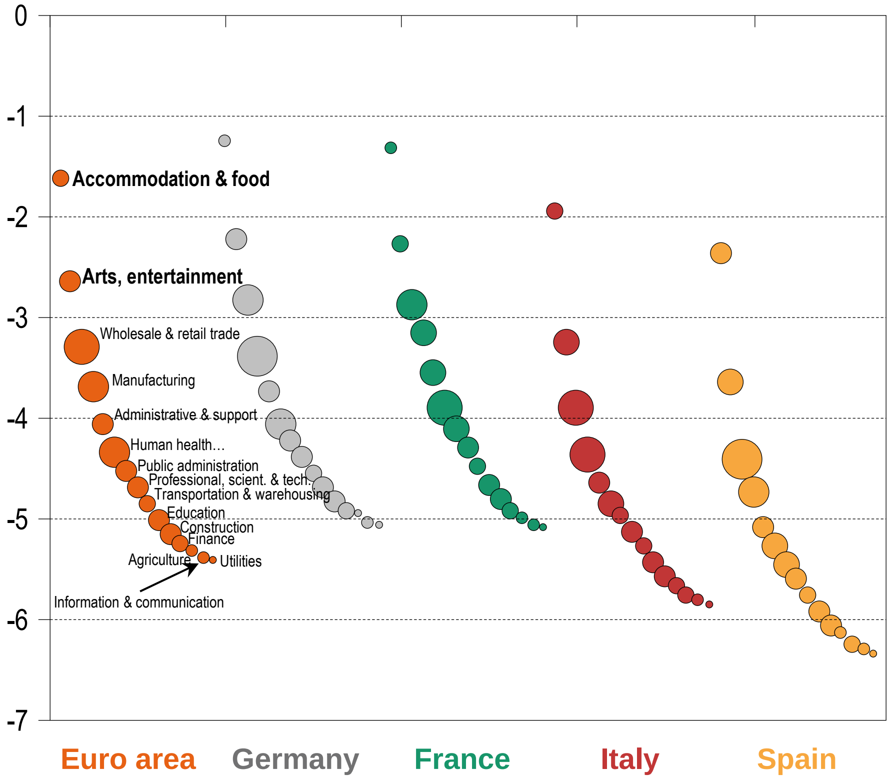
Expected fall in value added by industry in the euro area
(%, 2020)



Expected fall in total value added and employment by country
(%, 2020)



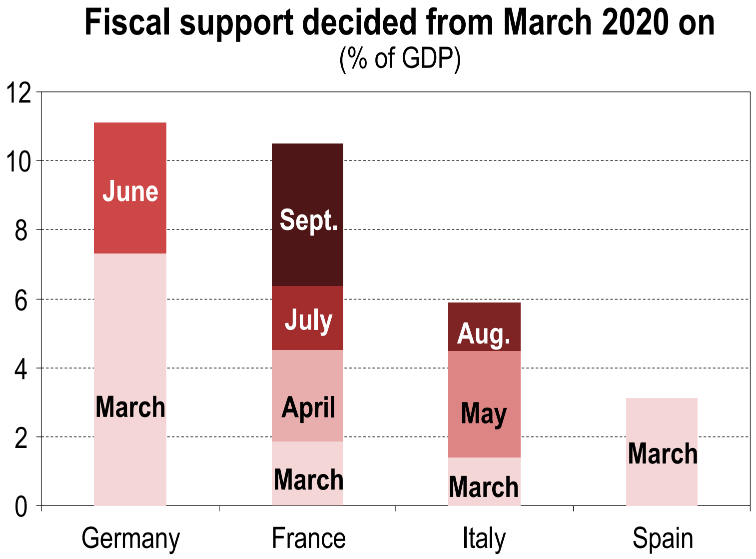
Cumulative fall in employment by sector
(%, 2020)

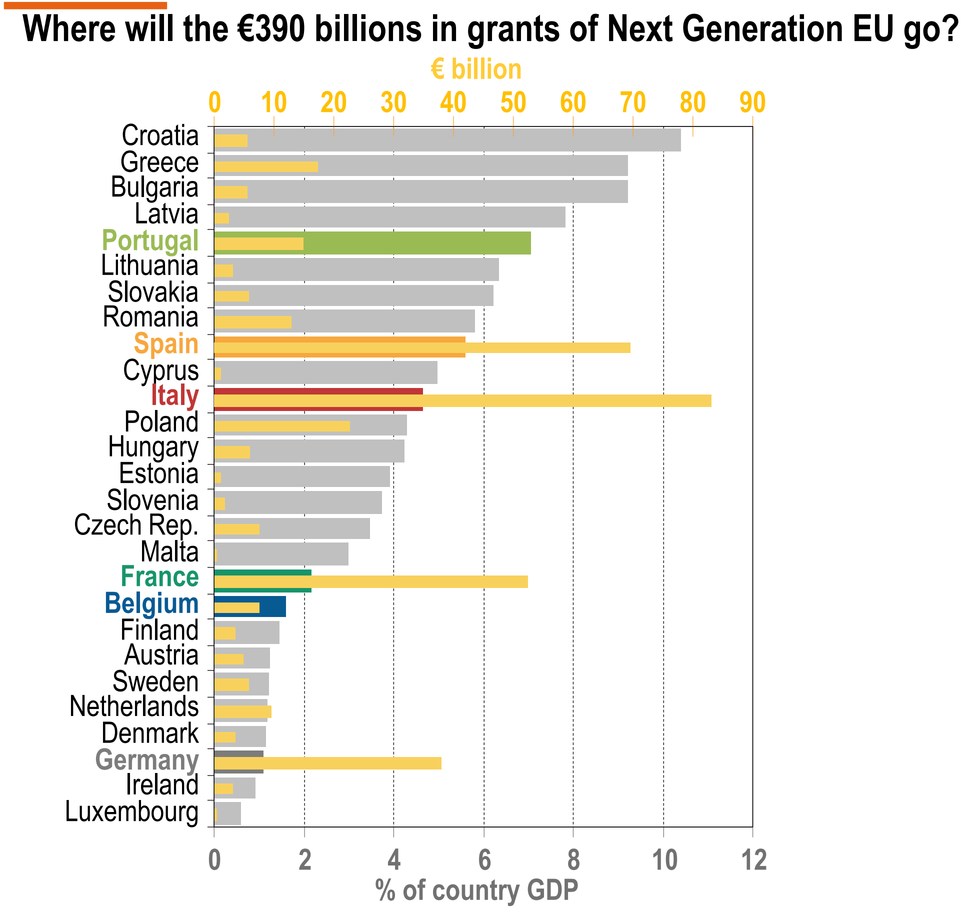


Bubbles' size is proportional to the industry's share in employment.

Sources: Refinitiv Datastream, Candriam

The support provided by national governments is not always commensurate to the shock each economy is confronted with



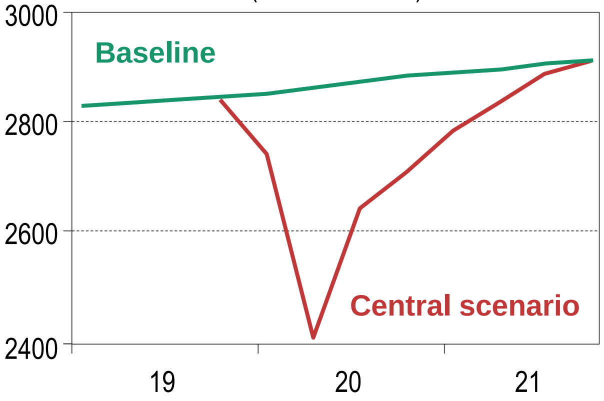


While the economic recovery has generally surprised on the upside, the persistence of downside risks has lead us to keep our moderately optimistic scenario

	GDP growth rate 2020	GDP growth rate 2021	Cumulated GDP loss* over 2020-21
Central scenario	-7.5	8.8	5.0

(*) Loss compared to the baseline

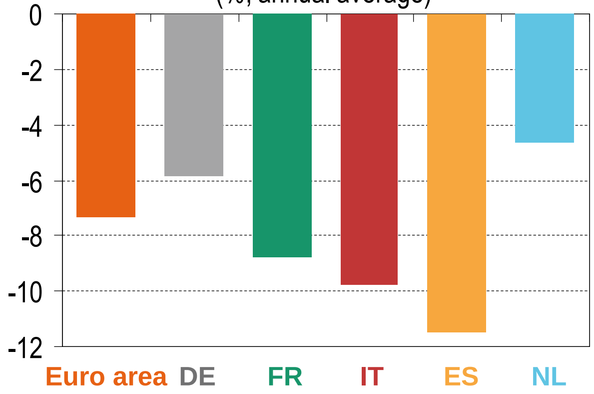
GDP level
(constant euros)



Impact on GDP level in 2020
(% against the baseline)

	March	April	May	June	July	Aug	Sep	Oct	Nov	Dec
Central scenario	-12	-21	-16	-10	-8	-8	-8	-7	-6	-5

Government growth forecasts for 2020
(%, annual average)

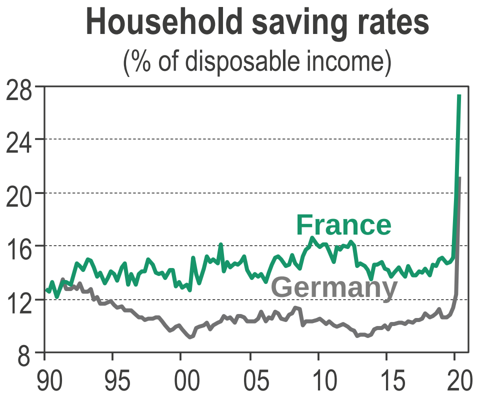


Source: Candriam

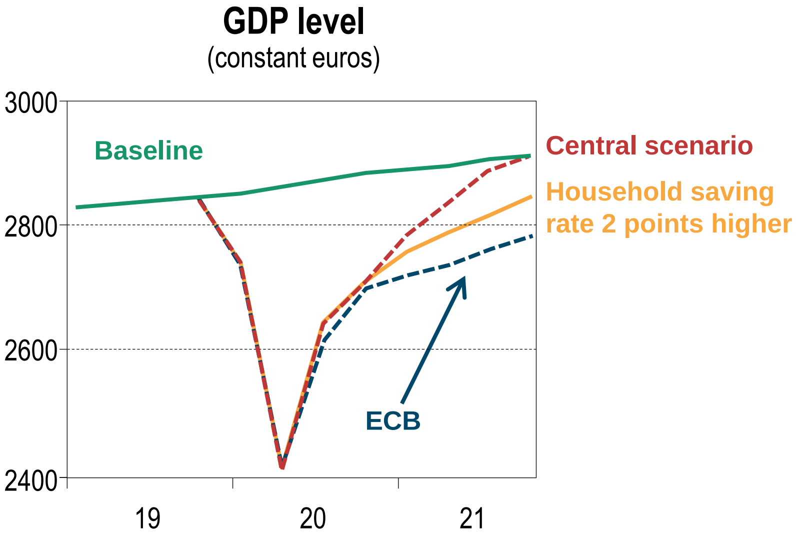
Still, this scenario could prove to be too optimistic if private agents confidence is durably weakened and governments are reluctant to add more support next year

A risk scenario

The behavior of all agents is becoming more cautious - household saving rate is falling only slowly; firms are reluctant to borrow to invest and banks are becoming more cautious in their supply of credit.



If, under these conditions, the support provided by the States is too timid, the expected rebound will be lessened... especially if the euro strengthen as the US political situation deteriorates.



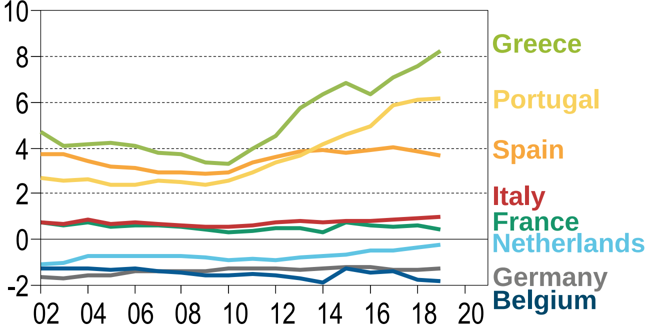
Sources: Refinitiv Datastream, Candriam

In such a scenario, growth divergences between euro countries could seriously worsen

If social distancing behavior were to continue, the Greek, Portuguese, and Spanish economies would be much more affected than those of the rest of the euro zone... and the state of their public finances would deteriorate as a result.

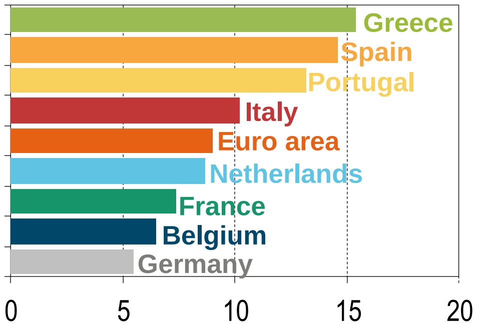
Net external balance of travel services

(% of GDP)



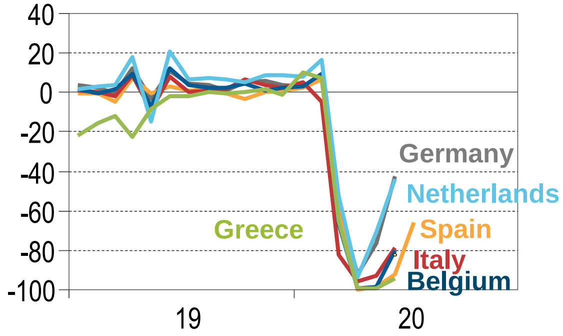
Household consumption of hotel and restaurant services

(% of GDP, 2019)

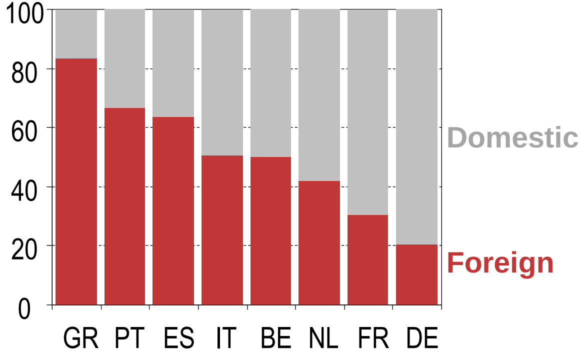


Nights spent at tourist accommodation establishments

(% year on year)



2019, by origin of tourists



Sources: Eurostat, Refinitiv Datastream, Candriam

In any case, it will be difficult for the ECB to provide much more support to the economy

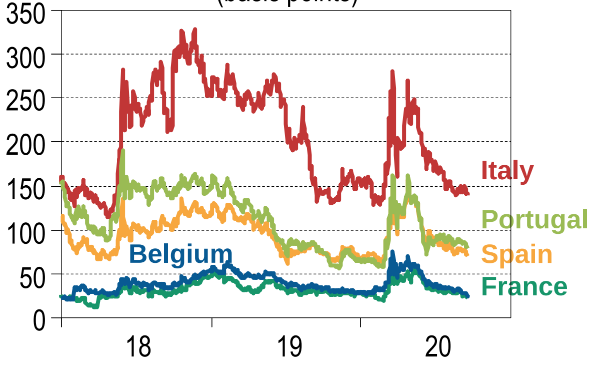
Main measures taken by the ECB

Between June 2020 and June 2021, the ECB will conduct **targeted refinancing operations (TLTROs)** at interest rates ranging from -0.5% to -1.0%.

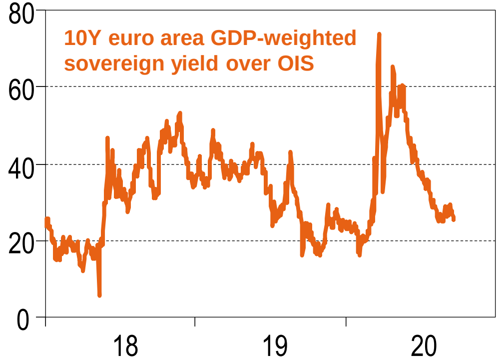
Increase in net asset purchases by 120 billion euros until the end of the year (in addition to the 20 billion euros per month already planned), with a greater focus on private credit.

Launch of a new 1350 billion euro Pandemic Emergency Purchase Program (PEPP).
This program is flexible: its size, duration and composition can be adjusted.

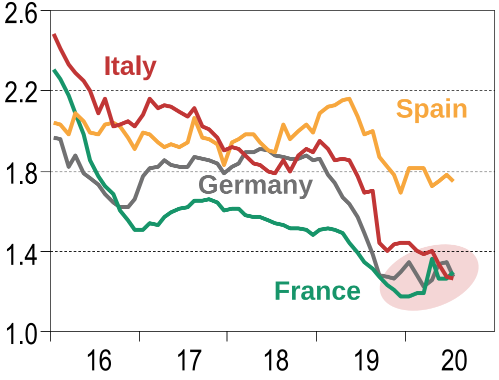
10-year government rate spread with Germany
(basis points)



Euro area sovereign risk premium
(basis points)



Interest rate on new loans for house purchase
(%)



October 2020

Sources: Refinitiv Datastream, Candriam

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