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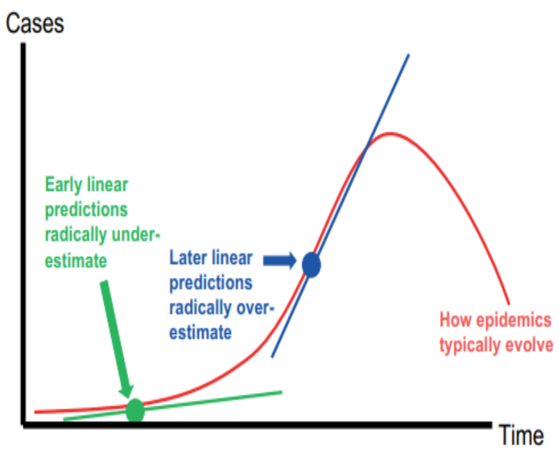
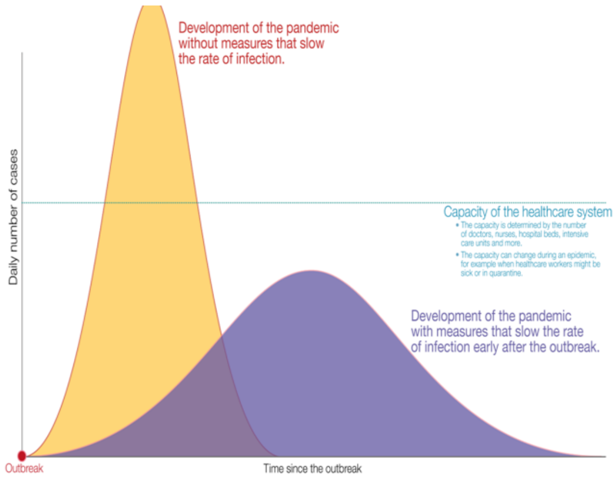
MACRO ECONOMIC UPDATE

March 2020

A very severe, but most likely temporary shock, is hitting the world economy

- ✓ A severe shock is hitting the world economy, both from a demand and supply side perspective (there's also a financial and confidence channel). It's a broad and global hit as we are talking about goods, services, people, short-term financial flows, FDI, international banking, corporates, commodities and exchange rates. Also, it's a pandemic. It's a supply issue because we are talking about significant disruptions in the global supply chain, factory closures, cutbacks in many services and activities. It's also a real demand issue (business travel, tourism, education, services, entertainment and leasure services, commodities,…). It's a confidence shock to the extent that high uncertainty will lead to reduced or delayed consumption of goods and services but also delayed or even foregone investment. Also, the sharp drop in energy and metal prices means that headline inflation will decrease substantially due to base effects kicking in. It will also impact investment.
- ✓ There's a lot we don't know and uncertainty looms large. The effects are non-linear, meaning that a longer lasting outbreak and even more drastic containment measures would have enormous knock-on implications. That said, even though we significantly downgrade our growth and inflation numbers for 2020 (after the draconian measures put in place in northern Italy over the weekend), our base case scenario still is that we're dealing with a temporary (albeit very severe) shock to the real economy. This means that economies are expected to recover once the uncertainty fades. True, the number of cases will continue to rise exponentially over the coming weeks. But, be careful not to extrapolate the rapidly rising number of infections. At the some point, as we are now seeing in China, the number of cases will come down. The lockdown measures are important to alleviate the stress on the healthcare system. It will flatten the curve of infections (see graph right below) but it will also come with bigger economic costs.





- ✓ In China, as the new cases of COVID-19 are falling every day, activity is slowly picking up again as factories are reopening. However, many companies are still operating below capacity and the fear of a second round of propagation of the virus is real as countries like Italy, South Korea and Iran are becoming new major hosts of the virus. PMI data also shows that employment in China has been impacted by the containment measures taken due to the COVID-19 outbreak, indicating that the economic impacts on the Chinese economy will not be only short-

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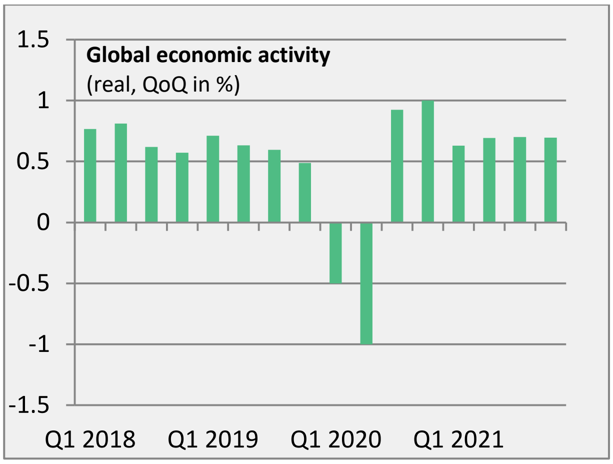
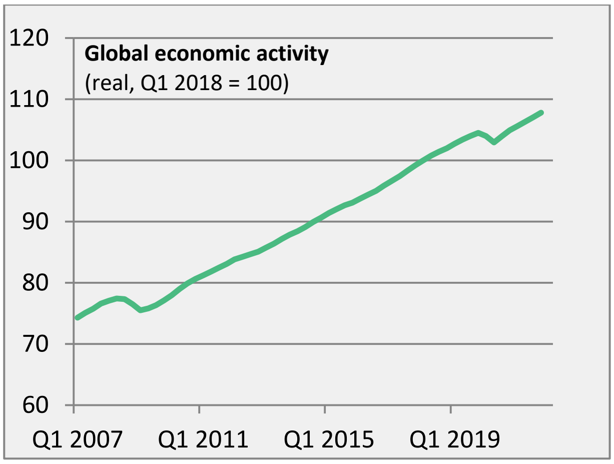
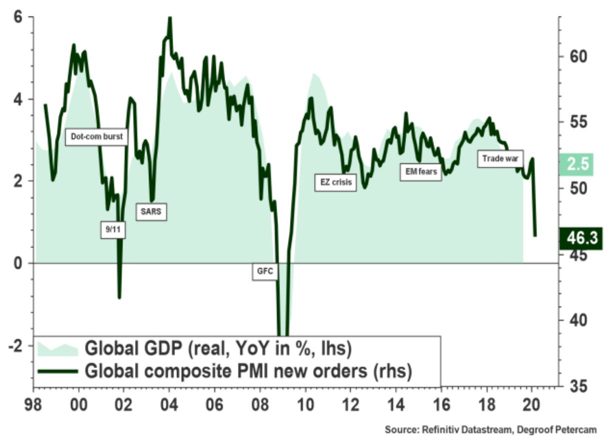
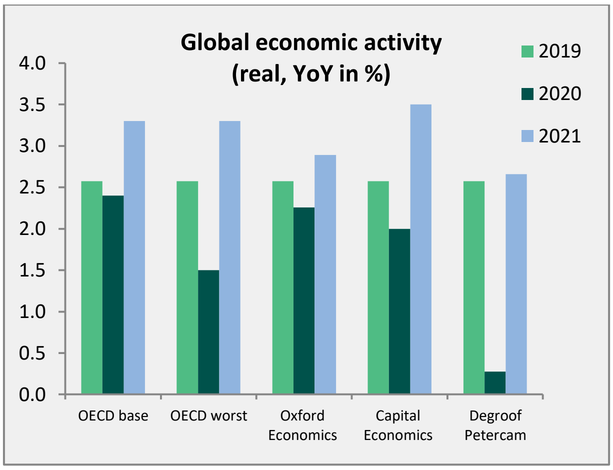
term, but some long-term effects might linger.

- ✓ Both monetary and fiscal policy has an important role to play (in a coordinated way) in order to cushion the blow and make sure this crisis will not become a self-fulfilling employment and credit crisis. Central banks stand ready to alleviate bouts of financial stress and provide liquidity. They should not remain sidelined (as some observers argue) and luckily they won't. Of course, from a pure rate perspective, given the very low policy rates already in place, this is a highly uncomfortable position to be in (but this was obvious all along).
- ✓ The Fed cut its policy rate by 0.5% (to 1.25%) and will do so again at its meeting on March 18 (or even sooner). The BoE will bring down its policy rate on March 26. The ECB will inject liquidity into markets by shoring up its QE-program (mostly through buying more corporate loans + do more generous tiering), by introducing TLTRO's targeted at SME-companies and by cutting rates (-0.5% to -0.6% or -0.7%).). The BoE will bring down its policy rate on March 26 or sooner. The BoJ is also taking more measures. Central banks in emerging markets will also ease
- ✓ Fiscal policy (in the form of automatic stabilizers, credit guarantees, temporary unemployment, cash for clunckers, delay tax payments, tax credits,…) should be more effective. This may take a bit of time and coordination efforts will prove difficult but at the end of the day they can and will make a significant difference. We also expect that governments across EM's will use fiscal policy to stimulate their economies; in Asia, China, South Korea and Malaysia have already announced such stimulus packages, but much more is expected in the next few months.









- ✓ Of course, we can and probably should talk about a (global recession) because the first half of the year will be heavily impacted. The magnitude remains to be seen and largely depends on how the virus develops and which measures are going to be put in place. To get a sense, this is what happens to global economic output if we consider a negative hit of global GDP of -0.5% in Q1 and -1% in Q2 before increasing to 0.9% and 1% respectively in Q3 and Q4. The exact estimates are highly speculative and subject to much uncertainty but should mimic the true pattern as it unfolds (at least in our base case view).

- ✓ All in all, below the surface, the underlying economic scenario of modest growth, low inflation and loose monetary policy remains in place (this is the secular stagnation/liquidity trap scenario elaborated on in previous communications). Moreover, the coronavirus again illustrates the complexity of long and complex global supply chains. These have already come under pressure over the last decade because of technological, geopolitical and environmental reasons, as highlighted before.

2020-2021 outlook for growth and inflation

Important note: be careful when interpreting the yearly growth estimates. It's the quarterly dynamic that matters most! For example Belgium had a very positive growth number in Q4 2019 (+0.4% QoQ) whereas growth in the Eurozone as a whole basically grinded to a halt. This has important base effects in 2020 as you can see in the table below.

	GDP				Inflation		
	2019	2020	2021		2019	2020	2021
US	*2.3*	**1.4**	**2.0**		*1.8*	**1.5**	**2.0**
		1.9	*1.8*			*2.0*	*2.1*
Eurozone	*1.2*	**-0.3**	**1.3**		*1.2*	**1.0**	**1.3**
		0.9	*1.2*			*1.2*	*1.4*
Belgium	*1.2*	**0.4**	**1.1**		1.4	**0.9**	**1.4**
		1.1	*1.1*			*1.4*	*1.6*
Japan	*0.8*	**-1.8**	**1.2**		*0.7*	**0.3**	**0.7**
		0.3	*0.8*			*0.6*	*0.7*
China	*6.1*	**3.0**	**5.0**		*2.6*	**2.0**	**2.2**
		5.6	*5.8*			*3.2*	*2.1*

Update 9 March 2020, *Consensus forecasts*