Investment Managers

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Research & Strategy Insights

Tougher winter, promising summer

Monthly Investment Strategy Op-ed

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Key points

- Vaccinations underway in the US and UK are a big boost for the outlook for 2021, but the benefits will still take time to arrive.
- In the interim, the latest virus outbreak complicates the outlook and will dampen activity in the US and Euro area over the winter.
- Fiscal policy support has been confirmed at the Euro area level; it appears forthcoming in the US.
- The ECB has extended its QE programme, while the Fed and BoE have also confirmed ongoing support into 2021.

One last (big) effort needed

Vaccinations have started in the US and the UK while within days the European Medicine Agency is highly likely to authorise the Pfizer and Moderna products. Of course, it will take quarters before "collective immunity" is reached and months before sufficient vulnerable people are vaccinated, enough to allow a full exit from the toxic cycle of lockdown and reopening. But at least we can look towards the second half of 2021 with substantiated hope. Santa this year is coming with a big syringe, and it's the best gift we could get in this dismal 2020.

Still, the next few months will remain complicated. In Europe, the second wave of the pandemic seems to be past a peak, which in most cases remained significantly lower than in March-April, but it is taking time to get it back fully under control. Germany, which had opted – again – for a lighter form of lockdown is moving towards a much more stringent form, while France has prolonged some of its restrictive measures well into January. The impact on Q4 GDP will be of course less than in Q2, and we have probably been too pessimistic with our -4% Q4 forecast for the Euro area, but at least some of the weakness that we expected for November and December is likely to materialise into 2021. This makes us unwilling to revise up our GDP forecast for 2021 of 3.7% despite a better carry-over from Q4 2020 – which would offset only roughly half of the GDP loss of 2020.

In the US, for now it does not seem that the second – or probably more accurately third in this case – wave has reached its peak. It is depressing to see that infection rates continue to rise in states such as New York which had done such a stellar job this summer to avoid the fate of the sun belt. We are comfortable with our current forecasts for the US though since we had from the start expected the bulk of the shock to materialise in Q1 2021 looking for a modest contraction in GDP at that time.

All this makes economic policy all the more crucial to cushion the current blow and limit the scarring effects which could otherwise impair the quality of the post-collective immunity recovery. By and large, the Euro area has dealt quite nicely with

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what could have been thorny institutional issues over recent months. At long last, the EU's Next Generation Pact can be implemented, thanks to a compromise found with Hungary and Poland over the "rule of law" enforcement issue. This won't materialise quickly, but the political message alone is another source of solidity for the monetary union, while the disbursements beyond 2021 will probably contribute to lift potential GDP in a region where it has been quite low (barely over 1%) since the financial crisis of 2008-2009. On the monetary side, the European Central Bank (ECB) has delivered what we think is a more than decent support package (a top-up of €500bn for pandemic emergency purchase programme (PEPP) which will now continue until March 2022 at least).

This does not mean the ECB is done with its famous "limits" – in our opinion the new extension was carefully calibrated to leave some "safety margin" from holding more than 50% of any government's eligible debt – but we think it will buy some "peace and quiet" on the European market and create the financial space governments need to continue supporting their economies. Fortunately, if indeed we are heading to a proper recovery in the second half of 2021, this should be the very last "big effort" the ECB would need to make.

True, the Governing Council will come under pressure as the end of PEPP nears. A "cliff" – shifting from "all out" quantitative easing (QE) under PEPP to the €20bn "trickle" under Asset Purchase Programme (APP) – could come too early in 2022, before governments engage in decisive fiscal consolidation, risking a recovery-killing brutal rise in risk premia. However, inflation should be low enough by then for the central bank to boost its "ordinary QE" quantum (the ECB's forecasts have inflation at only 1.4% at the end of 2023, significantly below its target even in three years' time). Indeed, investors should not over-react to the likely re-acceleration in inflation in the first half of 2021. Most of it will be purely the product of fading exogenous shocks (the temporary VAT rate cut in Germany, the decline in energy prices), while the endogenous engines of inflation would remain quite subdued in our view. Negotiated wages have already slowed down in reaction to the crisis, and consumer surveys suggest that households have been revising down their price expectations lately, while they continue to be very concerned about their job prospects. We would therefore see the rebound in consumer prices as we move further into 2021 as a pure mechanical "hump" and not the beginning of a proper normalisation in inflation which would derail the ECB's accommodative strategy. We suspect there will be a "complicated moment" for Christine Lagarde when discussing "life after PEPP", but we think (and hope) it will be more of a subject for the last Op-ed of 2021, rather than this one.

On the US side, we continue to wait for some "hard news" on the continuation of the fiscal stimulus, which is made urgent by the expiration of the emergency federal unemployment benefits at the end of December. There is still quite a dispute across the two parties on the breakdown of the next fiscal package, but there seems to be a growing consensus on the need for a stimulus larger than the $500bn which had until very recently been the "red line" of Republican Senators. We are inching towards our baseline of $1tn, 5% of GDP. This strengthens our call that US long-term interest rates should be on the rise in 2021, even if the Federal Reserve's (Fed) own extensive asset purchases should cap a material increase (we expect 10 year Treasuries at 1.20% by the end of next year). The Fed's actions to restrain rising yields may be all the more necessary if the Democrats win the two Senatorial races in Georgia on 5 January. We noted several polls making this plausible, even if of course the performance of US polling on state by state results has been poor lately and our base case remains that Republicans will retain control of the Senate.

The combination of a rebound in world demand with still accommodative monetary policy in the developed markets is of course supportive of Emerging Markets, and capital flows have returned to these counties over the last two months. This should be particularly positive for the Asian region, which so far has escaped for the most part the second pandemic waves. In other geographies, we think granularity is needed. The recent developments in Turkey – even if this is an extreme case – suggest that the space for more policy stimulus in some countries could now be limited, especially where inflation is already above target.

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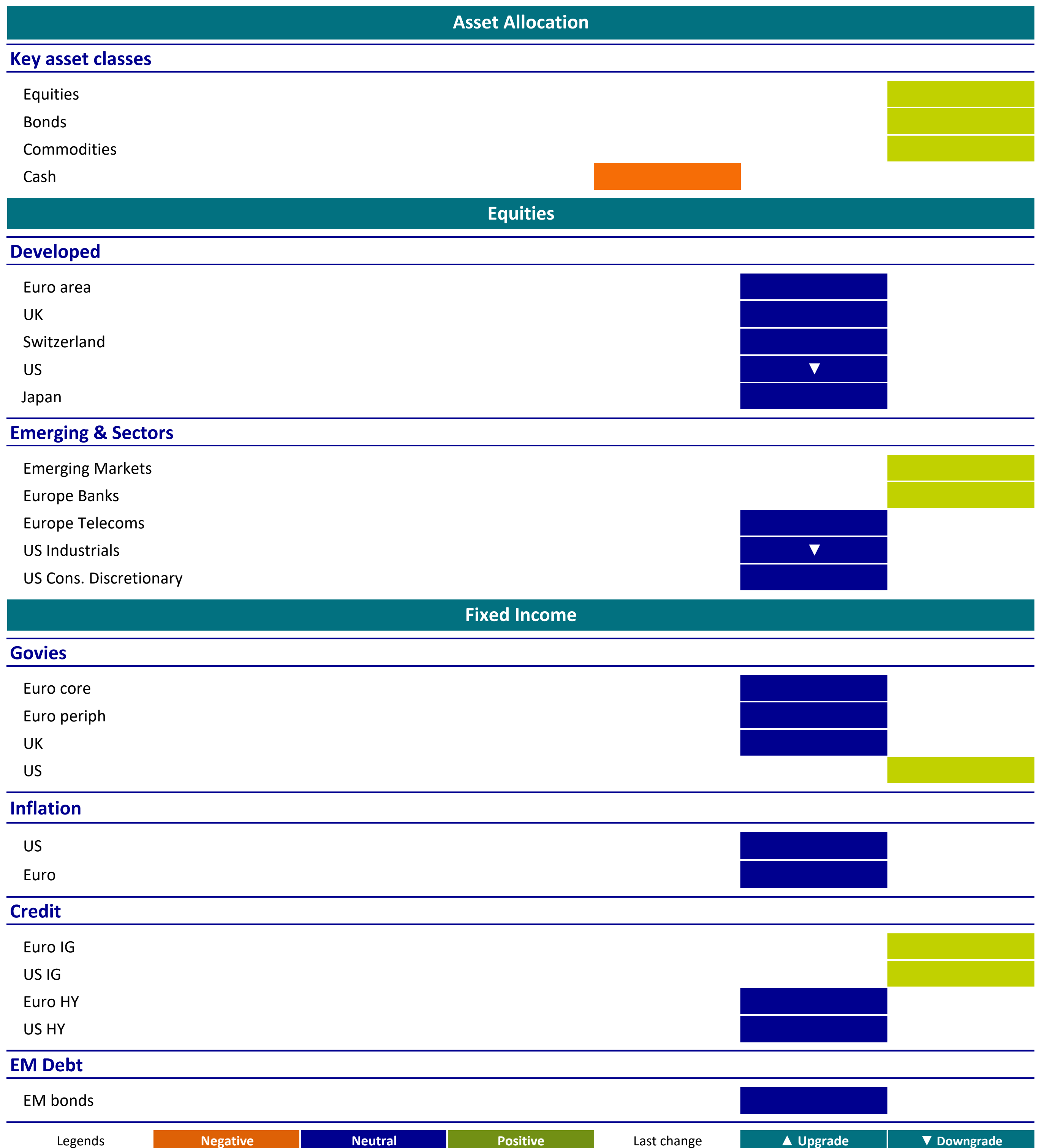
Recommended asset allocation



Source: AXA IM Macro Research – As of 17 December 2020

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Macro forecast summary

Real GDP growth (%)	2020	2021*		2022*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
World	**-4.0**	**5.2**		**4.1**	
Advanced economies	**-5.9**	**4.6**		**3.5**	
US	**-3.4**	**4.6**	3.7	**3.7**	
Euro area	**-7.7**	**3.7**	5.3	**4.4**	
Germany	**-6.0**	**3.0**	4.4	**4.6**	
France	**-9.6**	**4.5**	6.7	**4.9**	
Italy	**-9.2**	**4.2**	5.3	**4.2**	
Spain	**-12.0**	**3.5**	6.7	**5.2**	
Japan	**-5.5**	**3.0**	2.5	**2.0**	
UK	**-11.2**	**4.6**	5.7	**6.5**	
Switzerland	**-4.8**	**2.5**	3.7	**3.0**	
Emerging economies	**-2.9**	**5.5**		**4.4**	
Asia	**-1.4**	**7.1**		**5.1**	
China	**2.3**	**8.0**	7.9	**5.5**	
South Korea	**-0.8**	**3.5**	3.2	**3.0**	
Rest of EM Asia	**-6.0**	**6.4**		**4.7**	
LatAm	**-8.0**	**4.0**		**2.7**	
Brazil	**-5.0**	**3.4**	3.2	**2.0**	
Mexico	**-9.4**	**4.6**	3.7	**2.5**	
EM Europe	**-3.5**	**2.8**		**3.6**	
Russia	**-3.2**	**1.5**	3.1	**2.5**	
Poland	**-2.9**	**4.0**	4.2	**4.6**	
Turkey	**-2.0**	**3.5**	4.6	**4.6**	
Other EMs	**-3.7**	**3.3**		**4.1**	

Source: Datastream, IMF and AXA IM Macro Research – As of 17 December 2020 * Forecast

CPI Inflation (%)	2020	2021*		2022*	
		AXA IM	*Consensus*	AXA IM	*Consensus*
Advanced economies	**0.8**	**1.1**		**1.3**	
US	**1.4**	**1.7**	2.0	**2.0**	
Euro area	**0.2**	**0.5**	0.9	**1.0**	
Japan	**0.1**	**-0.2**	0.0	**0.3**	
UK	**0.8**	**1.8**	1.5	**1.5**	
Switzerland	**-0.7**	**0.0**	0.2	**0.2**	

Source: Datastream, IMF and AXA IM Macro Research – As of 17 December 2020 * Forecast

These projections are not necessarily reliable indicators of future results

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Forecast summary

Central bank policy
Meeting dates and expected changes (Rates in bp / QE in bn)

		Current	Q4 - 20	Q1 -21	Q2-21	Q3-21
United States - Fed	Dates	0-0.25	4-5 Nov 15-16 Dec	26-27 Jan 16-17 Mar	27-28 Apr 15-16 Jun	27-28 Jul 21-22 Sep
	Rates		unch (0-0.25)	unch (0-0.25)	unch (0-0.25)	unch (0-0.25)
Euro area - ECB	Dates	-0.50	29 Oct 10 Dec	21 Jan 11 Mar	22 Apr 10 Jun	22 Jul 9 Sep
	Rates		unch (-0.50)	unch (-0.50)	unch (-0.50)	unch (-0.50)
Japan - BoJ	Dates	-0.10	28-29 Oct 17-18 Dec	20-21 Jan 18-19 Mar	26-27 Apr 17-18 Jun	15-16 Jul 21-22 Sep
	Rates		unch (-0.10)	unch (-0.10)	unch (-0.10)	unch (-0.10)
UK - BoE	Dates	0.10	5 Nov 17 Dec	4 Feb 18 Mar	6 May 24 June	5 Aug 23 Sep
	Rates		unch (0.10)	unch (0.10)	unch (0.10)	unch (0.10)

Source: AXA IM Macro Research - As of 17 December 2020

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