

THE BIG PICTURE OF GLOBAL ECONOMICS

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Even the Turkey is Worried

- **President Trump's ongoing breaking with convention remains a risk to markets.**
- **COVID remains a significant near-term risk to the global economy and markets.**
- **US and Europe expected to see negative growth over the turn of the year.**
- **Fed expected to act in December probably by keeping long rates anchored.**
- **Value stocks will likely see profit taking, reversing some of the recent rally**
- **China's growth remains robust and broadening- and helped by cheap euro funding**
- **G20 focused on COVID and support for smaller economies**
- **UK and EU move closer to a deal..... sterling to \$1.40?**

As President Trump continues to break every presidential convention, maybe even the 'Thanksgiving Turkey' may be worried about his pardon! But more seriously, the lengths that the President is going to, to hold onto power, are worrying. I was struck by comments from Michael Cembalest, the chairman of market and strategy at JPMorgan, and a former colleague of mine, when he said "Bottom line: a lot of very unorthodox things have to happen for Trump to be re-

elected. Even so, I'm not ruling anything out". To me, the crucial point is not that Mike said what he said, it's more that JPMorgan allowed such a comment to go into the public domain. He surmises "Markets might react negatively if the US as the world's reserve currency nation is seen as sliding down a path toward electoral illegitimacy due to post-election manoeuvres by political parties".

COVID drags down growth as vaccines are set to launch

The markets' abiding hope is that the good news about a potential vaccine will overcome the near-term bad news about the impact of COVID-19 on global economic activity. However, the bad news at present is overwhelming. Some commentators described the US COVID situation as 'out of control', and in indeed even in Asia, we started to see recurrences in places such as Japan and Hong Kong. California has announced a night-time curfew as cases of COVID have overwhelmed the healthcare system. There is a risk of an even more significant lockdown if cases don't abate soon. California saw over 1,000,000 cases with a record 15,500 last Friday.

Much of the global focus to date has been on the damage to European growth. Economists expect Europe to be back in a recession in the fourth quarter. However, economists are now expecting the United States to see negative growth in the first quarter of 2021.

The risks of a material loss of momentum in the US economy has yet to focus the minds of many policymakers/politicians. The gung-ho policymaking from the White House, with the US Treasury deciding to withdraw support for \$450bn of Federal Reserve credit facilities only exacerbates the near-term challenges for the US economy. There is still very little sign of Congress approving a fiscal package.

The emphasis for US 'save-the-economy' policymaking is likely to fall on the Federal Reserve. We expect the Fed will have to step in and provide some help at their December meeting. Many of the Fed governors have noted the downside risk to the economy. Such worries are likely to raise the chances of the Fed extending the weight of their bond-buying to longer-dated securities. **Hence, we expect longer duration bonds to continue to rally in the coming weeks.**

The key near term challenge is to gauge whether the financial markets can see through the current weakness and look forward to the rebound in 2021. A vaccine that allows us more mobility, and growth that is on a clearer path of recovery would be a good backdrop for risk markets. Indeed, Pfizer is increasingly confident that they can distribute their vaccine from around the middle of December. However, there is investor concern that the near-term slump in economic activity could lead to downside risk in markets. To be sure, the current downturn in growth cannot be good news for some of the cyclical sectors that have shown a marked recovery in recent weeks. There is a risk that the equity market reverts to its previous themes of growth-is-good and everything else can wait.

China continues to grow

China remains the stand-out country with economic activity data showing steady growth in October with a broadening up gross into the service sector. Service sector output was up 7.4% year on year in October, now more robust than the manufacturing sector growth. Although

China's economic momentum is vulnerable to a slowdown in global growth, most economists expect domestic demand to be the backbone of growth into 2021.

China's increasing financial globalisation was very evident with its first euro-denominated bond sale in about a year. They took advantage of the ultra-low borrowing costs available in the market. China raised 4 billion euros in a three-part offer that drew more than 17 billion euros of bids. Analysts expect China to continue to build a euro-denominated sovereign benchmark yield curve. It is extraordinary to think that a country with nominal GDP growth of around 6% per annum can fund itself at 12.5bps, albeit in a foreign currency.

G20 – cohesive decision making, ex US

G20 was meeting online over the weekend hosted by Saudi Arabia. The early discussion centred around the fair distribution of COVID vaccines with nations asked to contribute to the global project for vaccines, tests and therapeutics called Access to COVID19 tools (ACT) Accelerator. In other measures, **G20 endorsed a plan to extend a freeze in debt service payments for the poorest countries to mid-2021**, emphasising the international support for local currency debt at present.

Brexit – the final act?

Don't look now but we may be approaching the endgame on Brexit, at least on the trade deal if not its consequences. In time-honoured European fashion, deadlines are miraculously dissolving as the end of the transition phase (January 1, 2021) approaches. There is even the prospect that ratification by the EU Parliament might not be required by year end. The European Council of heads of government, if needs be, may be able to pre-ratify an agreement. With time decay taking on a new meaning, **the effective negotiation deadline has slipped back to early December** with the usual panoply of emergency summits required. The most likely 'final' date for a sign-off is the EU summit on December 10/11th.

What is increasingly evident is that, aside from some last-minute theatrics, the UK and EU will agree a deal. The differences between the two sides at this point do not justify the political and economic consequences of a collapse into a no-deal. The deal envisages a transition arrangement of up to 10 years for EU fishing rights in UK waters. A set of agreed principles rather than prescriptive codified rules should resolve the issue of regulating state aid. The governance arrangements covering any deal will take their cue from the Joint Committee in place to cover the Northern Ireland Protocol agreed in the Withdrawal Agreement. It seems the UK will quietly drop the disputed sections of the Internal Markets Bill, which previously reneged on certain terms of said agreement. Aside from occasional bursts of derision, the agreement will quickly pass into UK law.

So far, so comforting after such prolonged agony. **Yet, the UK is only just about to start to feel the economic consequences of Brexit.** For example, it is clear to us that UK logistics firms are not adequately prepared for the transformation at the border. Supply chains face significant disruption at a time when the pandemic is still severely hampering retail businesses. Estimates of the impact on GDP over the medium/long term of the Johnson thin, hard Brexit deal average around 5%, relative to where it would be if membership had continued. The equivalent figure for No-Deal is 7-8%. Short and longer-term, Brexit is a negative supply-side shock to be reflected

in weaker net exports and business investment, even as Covid-19 impacts reverse. The consequences are stark as the trading shock complicates recovery from the pandemic in the services sector. This will surely invite more stimulus from the Monetary Policy Committee in the new year, including dancing around the issue of negative interest rates, and another bout of sterling weakness at least against the euro.

The better news on Brexit, at least in terms of the UK leaving with an agreement, has not been lost on the pound. Sterling has continued to make progress off its base at \$1.30. The pound at \$1.3322 has the previous high of \$1.3384 in sight, which if it breaks through, could see the currency make progress towards \$1.40.

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