INDOSUEZ
WEALTH MANAGEMENT

GLOBAL OUTLOOK 2020

MARKETS, INVESTMENT & STRUCTURING – H2 2020

MARKETING MATERIAL

POLICY MIX POST COVID-19: A REGIME CHANGE?

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TOWARD A REGIME CHANGE?

"*Those who cannot remember the past are condemned to repeat it*" George Santayana

The year 2020 will perhaps be noted as a landmark date in the history books of this century, not only because of the devastating economic effects of the current pandemic, which has brought a decade of growth to a halt, but also because of the new economic regime that is now taking seed.

Indeed, the unprecedented response by governments and central banks to the COVID-19 crisis represents a break with the policy mix that we have known over the past few decades. In this terra incognita, comparisons abound, and we can find points of similarity with the 1930s (the New Deal), the post-war period (the extension of the Welfare State), and the 1970s. However, some factors of change had already begun to emerge during the past years.

In the Euro Zone, the doctrine of fiscal austerity had already resulted in a European Commission more incline to accept fiscal expansion, faced with the populist risk and social tensions, as long as it was combined with structural reforms. As of 2013, the International Monetary Fund (IMF) had admitted to having underestimated the recessive effect of austerity. More recently, Emmanuel Macron's economic strategy in 2017 also marked a change versus the two previous presidencies, with an economic policy focused more on reforms aiming to boost growth than on traditional policies of making budget cuts.

The policy mix had also evolved in the United States, where we can talk more about an acceleration in monetary and fiscal interventionism than a real shift; the Trump administration was never partisan to fiscal austerity and the Federal Reserve initiated a change in regime from its first quantitative easing of 2008, which marks the entry into the monetisation of debt.

Moreover, the rise in inequality had become a topic of concern acknowledged as far away as in Davos and Stockholm, as reflected also in the number of Nobel prizes awarded to economists from this school of thought, after decades of domination of the neoclassical school. "*What else does the history of ideas prove, than that the intellectual production changes its character in proportion as material production is changed?*" wrote Karl Marx.

The theme of "happy globalisation" has come under growing scepticism in light of the changing climate and social inequality which it contributes to accelerating, and the urgency of the fight to contain global warming was already inspiring reflections about the need for a monetary "Green QE", or a fiscal "Green New Deal".

However, the COVID-19 crisis, through the scale of the shock it is generating, the extent of the response it implies, and the lasting consequences on our debt trajectories, is probably the catalyst of an acceleration in a - now more accepted, more clearly defined and aspired to - change of regime. Here again the comparison with the worst recessions of the last century has inspired governments to take unprecedented action in terms of size and in some cases their innovation. There is nevertheless a paradox in this novelty, which brings us to an economic policy regime and school of thought closer to that of the second half of the 20th century, at least at the fiscal level.

COORDINATED INTERVENTIONISM

This shift is especially visible in the rise in deficits and subsequent higher debt, the result of the greater interventionism by governments, leading them to deviate farther away from the golden rule of fiscal policy and reflecting strong pragmatism in the face of a very adverse situation as much as a new ideological consensus. This inevitably leads to the issue of the sustainability of the debt. The government's post-lockdown financial equation once again raises the question of a coordination of the policy mix, with the function of the central banks increasingly becoming to monetise the debt and keep interest rates sufficiently low to make it sustainable. In short, the implicit has become explicit, and the gradual extension of the scope of intervention of the European Central Bank (ECB) - far from the initial vision of a common monetary institution modelled on the Bundesbank - is undoubtedly partly what bothers the German Constitutional Court. Saying and repeating "whatever it takes" comes down to acknowledging disregard of the principle of proportionality of decisions to objectives.

CENTRAL BANK INDEPENDENCE IN QUESTION

Beyond the case of the ECB, the question is that of the independence of the central banks when the borders between fiscal and monetary policies are removed. We will probably not return to the central bank regime of the 1960s, and their power has become too great to think that they could be politically controlled. But a new relationship is forming which finds its roots in the first quantitative easing in 2008. What characterises this new alliance between fiscal and monetary policy is very strong interdependence and close coordination, with repeated cross injunctions for greater action. Ultimately, central bankers are walking a sort of tightrope, between keeping the proper distance from governments, maintaining their credibility, which requires an independent policy guided by rules, and maintaining confidence in public debt, which implies the lasting monetisation of the deficits.

SHARING THE BURDEN

The question of the breakdown of the fiscal effort will also be raised. Following this sharp increase in deficits linked to governments' efforts to counter the impact of the lockdown measures that they themselves have decided to take, it is possible that they will not make the same type of adjustment to spending as 10 years ago, due to the impact this had on growth and the political and social cost. The response is likely to partially involve tax increases for the major economies. The breakdown of the effort goes past the tax issue and is also based on that of sharing and added value. Without returning to the social regulation and wage/price indexation of the 1970s, more balanced sharing of productivity gains could pave the way for more self-sufficient growth, and a more robust consumption/investment combination, which the negative rates have been unable to revive over the past decade. This could lead to a pace of inflation closer to that of the two previous decades, notably if the convergence of the standard of living of emerging market countries reduces pressure on wages.

THE INTERNATIONAL SYSTEM

The world after COVID-19 will not mark the end of globalisation, but could be characterised by five changes: a tenser relationship between China and the United States, the evolution of value chains, growth driven more by domestic growth than international trade, strong protectionist pressures, and the carbon impact increasingly taken into account in transportation costs and in the international optimisation of production locations far from distribution markets.

Lastly, shifts in economic regime have historically led to changes in exchange rate regimes (the gold standard from 1879 to WWI, the currency areas of the 1930s, the Bretton Woods system from 1944, the end of the gold/dollar convertibility in 1971). There is huge uncertainty as to the possible scenarios of a reconfiguration of our existing currency regime. A key factor of the period into which we are entering is probably that of a calling into question of the value of currencies against gold if all of the central banks increase the size of their balance sheets. The second characteristic of this new paradigm will possibly be the acceleration of the rise of the yuan to reserve currency status, and potentially an anchor currency for other currencies in the region. In this context, the euro is set to remain a reserve currency but will continue to be at the mercy of the improvement in fiscal coordination and the perpetuation of the role assumed by the ECB in a still incomplete monetary zone.

The world after COVID-19 and the resulting policy mix is looking more complex for investors. Expected long-term returns will be impacted by a phenomenon of "financial repression" on bonds (persisting low rates) and equities (returns affected by the calling into question of dividends and the risk of a rise in taxation in the medium term). In this context, the polarisation of the equity markets is likely to increase, with an even greater domination by the tech giants.

In short, the policy mix regime we are heading towards is not that of the 1930s, the post-war period or the 1970s. It will consist as much of monetary innovations as elements borrowed from the fiscal philosophy of the previous decades, but in a renewed globalised framework, and marked by an acceleration in technological and climate change. This regime will only be sustainable if it succeeds in managing the exit from the crisis and the ensuing mountain of debt; as wrote Alexis de Tocqueville, "when great revolutions are successful their causes cease to exist, and the very fact of their success has made them incomprehensible" (*The Old Regime and the Revolution*).

Seljalandsfoss, Iceland

FOCUS

DEBT SUSTAINABILITY AFTER COVID-19

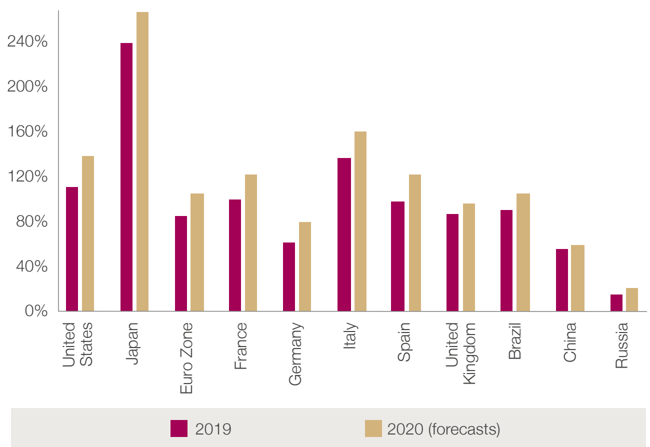
The unprecedented fiscal support plans that have been announced since the month of March 2020 will lead to a significant increase in the debt-to-GDP ratio in most countries, probably in a range of 5 to 25 points at end-2020 (Chart 1), due to the rise in the deficits stemming from the drop in economic activity this year. This obviously raises questions as to the sustainability of sovereign debt in the long term, against a backdrop of investors fearing another crisis like the one in 2011 in the Euro Zone, although the policy-mix and the range of policy tools have evolved greatly since then.

Is there a risk level in terms of the debt-to-GDP ratio?

Carmen Reinhart and Kenneth Rogoff, in their book entitled *This time it's different* (2009) and their paper *Growth in a time of debt* (2010), argue that for levels of debt in excess of 90% of GDP, governments run a higher risk of seeing a lasting decline in GDP growth, losing control of the debt-to-GDP ratio and, in some cases, losing control of inflation. The basic rule of sustainability of the debt-to-GDP ratio is expressed through the difference between the real interest rate (i.e. net of inflation) and the economic growth rate.

In certain configurations, the increase in debt makes the markets more distrustful, leading to a rise in the interest rate at which the country in question is financed, which automatically results in a deterioration in budget balances, requiring fiscal adjustments that are painful for growth: this was the case for several countries in the European Monetary System (EMS) in the 1990s and the case of the southern European countries from 2011 onwards.

CHART 1: DEBT-TO-GDP RATIOS, %



Source: IMF, OECD, Indosuez Wealth Management.

The specific case of emerging countries can lead to a monetary policy dilemma, between a recessive fiscal adjustment and the simultaneous loss of control of inflation and the currency; this risk increases when a significant portion of the debt is denominated in dollars and held abroad; this was the case during the Asian crisis of 1997, or more recently in the case of Argentina.

The low growth in the Euro Zone in the decade following the 2008 financial crisis is nevertheless explained as much by the fiscal austerity measures imposed by the European Union (EU) budget rules as by the need to control the impact of the rise in debt on the yield curve. In the case of the southern European countries, the situation had become difficult to control, not only due to the combination of real interest rates and growth, but also with respect to the recessive effects of the fiscal adjustments which deteriorated this dynamic further, with an underestimated multiplier effect; this is what made the ECB's action from 2012, and especially from 2015, inevitable.

The role of the central banks and impact of the sovereign debt purchases on the yield curve do indeed change the situation in terms of sustainability. For example, the experience in Japan, the United States and Europe over the past 10 years highlights a break in the relationship between debt levels and the interest rate: the spread of the price of France's debt relative to Germany's remains quite moderate although France has a debt-to-GDP ratio of 100% and will exceed this level very significantly this year. The Trump administration implemented a fiscal reform leading to a strong rise in the country's debt without its effects being felt on the US yield curve beyond what can be explained by the rate hikes made by the US Federal Reserve (Fed) in 2018.

In any event, this deeply transformed framework raises the question of the relevance of the level of debt-to-GDP and growth in the Stability Pact defined by the Maastricht Treaty in a very different world from our current one in terms of interest rates, inflation, and monetary policy.

What factors affect debt sustainability?

The examples of the Euro Zone, Japan, and the United States demonstrate that debt sustainability depends above all on the level of the interest rate paid on it, by central banks. Instead of leading to a rise in interest rates, the increase in public debt has forced central banks to maintain a low-interest rate environment, precisely to make the debt sustainable well above the 100% debt-to-GDP threshold.

The nature of monetary policy thus plays a significant role in the sustainability of the debt. While the yield curve in Japan is fully controlled by the central bank, in Europe the uncertainty as to the ability or will of the European Central Bank (ECB) to support permanently the debt of the member states through its asset purchase policy is precisely what led to the sharp increase in the risk premium on Italian debt in the first quarter of 2020. The COVID-19 outbreak that has ravaged Europe since February caused a new episode of stress on Italian spreads, which undoubtedly contributed to the ECB's decision to announce a massive increase in its asset purchases for an amount of 750 billion euros. Everything is therefore being done in the main countries so that the rise in debt does not lead to an increase in the states' financing spreads.

This holds true as long as the political framework and financial trajectory are readable. In Italy, during the past three years, it was rather the level of political uncertainty and disagreements between the previous government and the European Commission which contributed to a rise in spreads, than then the debt levels in the Euro Zone. The readability of the fiscal path also plays an important role in the confidence the market has in a country via the level of the risk premium; this is the aim of the budget rules and three-year stability programmes presented by the member states to the European Commission.

Lastly, as mentioned above with respect to the emerging countries, the currency denomination (Chart 2) and holding structure of the debt (Chart 3) all have significant impact on its sustainability; this can be reflected in the level of stress on the currency, notably for countries whose currency is not a reserve currency, and where a debt crisis can be followed by a currency crisis. A country's percentage of debt held domestically its current account (Chart 4) and its level of currency reserves are from this viewpoint two fundamental factors to ensure an economy's resilience to an equivalent debt level. This partly explains, for example, why China's public debt is deemed sustainable by the market.

Will the increase in sovereign debt accumulated this year hamper growth?

As mentioned above, the past decade in the Euro Zone has already raised the question of the potential impact of the significant level of debt on growth. In the Euro Zone, the most indebted countries are also those that have recorded the lowest growth rates. This reflects the burden of debt payments and deleveraging on the future growth of a country that accumulates debt. The weight of servicing the debt restricts government spending, transfers, and investment if the country wants to control its deficit-to-GDP ratio, which thus means a transfer of wealth between two decades and even two generations.

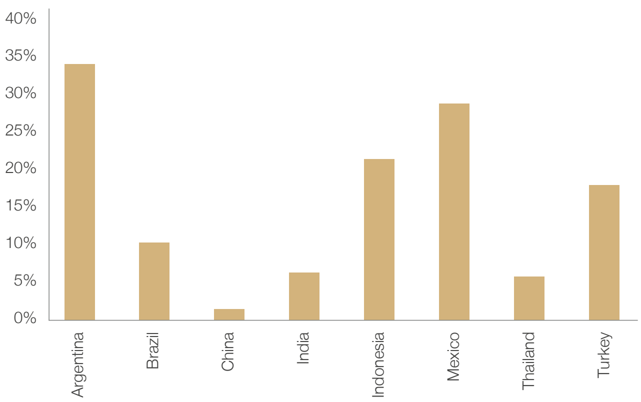
Debt payments weigh on potential growth in cases where it results in governments having to make budget choices that can affect not only the cycle but also long-term growth, for example by reducing spending on education, research, healthcare or infrastructure, which contribute to boosting the growth rate and the standard of living of the following generation. Everything also depends on whether the items to which the additional debt was allocated consist of expenses or if they contribute to types of investments that would increase potential growth.

We can also consider that the massive support programmes announced by the main countries in the spring of 2020 are intended to avoid the destruction of productive capital; from this angle, they contribute to preventing a temporary shock from becoming a structural shock, thereby preserving the growth path, which would have been more durably affected in the absence of support measures.

Does the stock of government debt held by the central banks change how we measure sustainability?

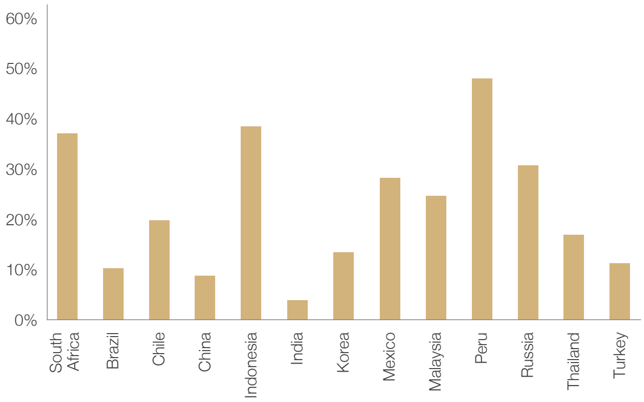
The rise in the debt-to-GDP ratios to above 100% in most OECD countries inevitably leads to the question of their future repayment. However, we can wonder about the treatment of the part of public debt that is held by the central banks: is it still debt, or is it money? If the central banks do not reduce their balance sheets and reinvest the maturing assets in the debt of their respective governments, the coupons on which are earnings for the central banks (and thus received by the government), we could *de facto* consider this debt to be money creation.

CHART 2: EXTERNAL DEBT-TO-GNI, %*



* Present value of external debt in USD expressed in % of Gross National Income.
Source: World Bank, 2018 data, Indosuez Wealth Management.

CHART 3: FOREIGN OWNERSHIP OF LOCAL CURRENCY DEBT, %



Source: Datastream, BIS, World Bank, IMF, Indosuez Wealth Management.

Consequently, we could theoretically recalculate the debt-to-GDP ratios of Japan, the United States and Europe by subtracting the amount held by the central banks if it is certain that the central banks will not backtrack on their quantitative easing and balance sheet expansion. This nevertheless implies two things: that the asset purchase programmes are permanent, and that the monetisation of public debt is accepted.

This latter point is a topic of debate in the Euro Zone, as the Statute of the European Central Bank (ECB) does not permit the direct financing of member states, and was also the subject of proceedings launched before the Court of Justice of the European Union (CJEU) and the German Constitutional Court in Karlsruhe. In this context, we can consider that the persisting dual uncertainty about the permanence of the monetary support and budgetary solidarity justifies the tenacity of risk premiums on several of the Euro Zone countries, exactly reflecting the doubts about the sustainability of the debt.

Does the increase in public debt create an inflationary risk?

In the past, debt crises have sometimes led to a rise in inflation; in addition to the above-mentioned cases of the currency crises in emerging countries, which generate imported inflation. Moreover, inflation has been a solution to reduce the weight of the debt without having to default by improving the real interest rate/ economic growth relationship.

The question was raised again during the Fed's quantitative easing implemented from 2008, on the basis of the monetarist conviction that an increase in the money supply inevitably leads to a rise in inflation. In this analysis, if public debt is monetised, an increase in this debt should lead to higher inflation. This is not what has been observed over the past decade, which has been marked more by an inflation of asset prices through an automatic effect of the low interest rates. The source of the weak inflation appears to be more anchored in structural factors and the European Central Bank has failed to bring inflation to its target, thus we can rule out this prospect in the short- and medium terms. A rise in inflation could come rather from a more structural change in globalisation or in the sharing of added value.

Whichever the case, whether through inflation or by maintaining low interest rates, solving the equation of the rise in public debt appears to imply a transfer at the expense of savers, a theme of financial repression that has sparked strong debate in Germany over the ECB's policy.

Will taxes rise following the pandemic?

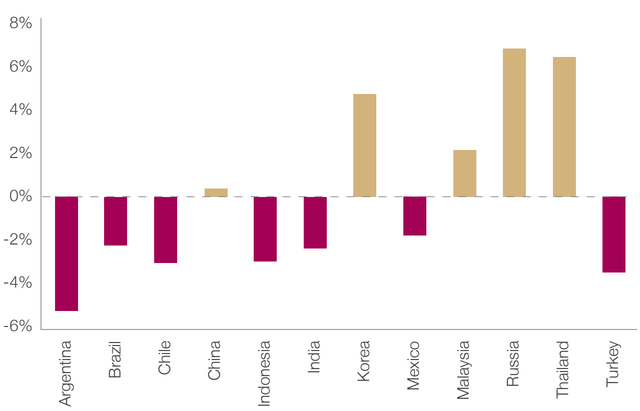
In this phase, the governments' priority is to contain the impact of the spread of the outbreak on the economy and create the conditions for a rapid restart while limiting the long-term effects of the transmission of the shock. Tax increases are therefore not possible in the short-term, either politically or economically, and the central banks are there to ensure the financing of this additional debt at zero or negative rates.

The above-mentioned fiscal multipliers (which have been underestimated during the past decade) shows that governments have learned lessons from the two crises of 2008 and 2011 and the recessive effects of the fiscal adjustments implemented in southern Europe.

But the question will inevitably be raised again as to how to find the resources to enable a rebalancing of the public accounts, in a context in which the automatic fiscal stabilisers operate in an asymmetrical fashion in Europe (Chart 5) (they contain the effects of the crisis thanks to the safety nets, but in an expansion phase the budgets do not return to a surplus, with the exception of Germany).

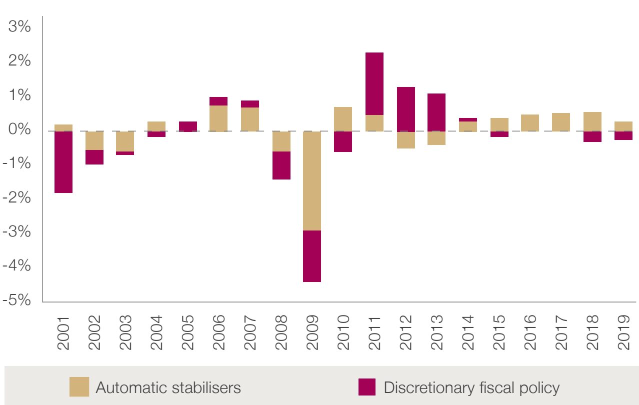
Furthermore, a rise in income and wealth inequality and acceleration in global warming could lead some governments to consider fiscal reforms in these two directions, faced with public opinion mobilised around these issues. These will probably be key topics in the next elections in the United States and Europe.

CHART 4: CURRENT ACCOUNT, % GDP



Source: World Bank, 2018 data, Indosuez Wealth Management.

CHART 5: CONTRIBUTORS TO CHANGE IN THE FISCAL BALANCE OF THE EURO ZONE, % GDP



Source: European Commission, Indosuez Wealth Management.

Vienna, Austria

POLICY-MIX, GOVERNANCE, AND COORDINATION

According to a traditional and academic view, the monetary and fiscal components of economic policy have distinct and independent roles, but work to fulfil partially shared objectives in steering the cycle:

- Monetary policy must focus firstly on the growth/inflation equilibrium of the cycle via its short-term interest rate policy and its transmission to the financing of the economy and, in exceptional circumstances, play the role of cornerstone of the financial system, for which it carries out the function of liquidity provider and lender of last resort;
- Fiscal policy covers a large variety of objectives that are often in competition with each other and are dosed differently from one country to the next; but we can consider that fiscal policy aims to ensure the macroeconomic steering (via automatic stabilisers and the option to discretionarily increase the deficit or add rigour), implement structural policies with an impact on potential growth (notably health, education, infrastructure) and fulfil a redistributive role, that is more or less significant depending on the political orientation of the governments.

THE REGIME OF THE PAST THREE DECADES

The dual trend of the globalisation of the economy/dismantling of the welfare states, in a context of greater tax competition, as well as the failures of unilateral fiscal stimulus policies, tended to consecrate monetary policy as the favoured instrument to steer the cycle at the turn of the 1990s. This is especially true as the central banks have seen their credibility strengthened by their independence and the extension of their scope of action.

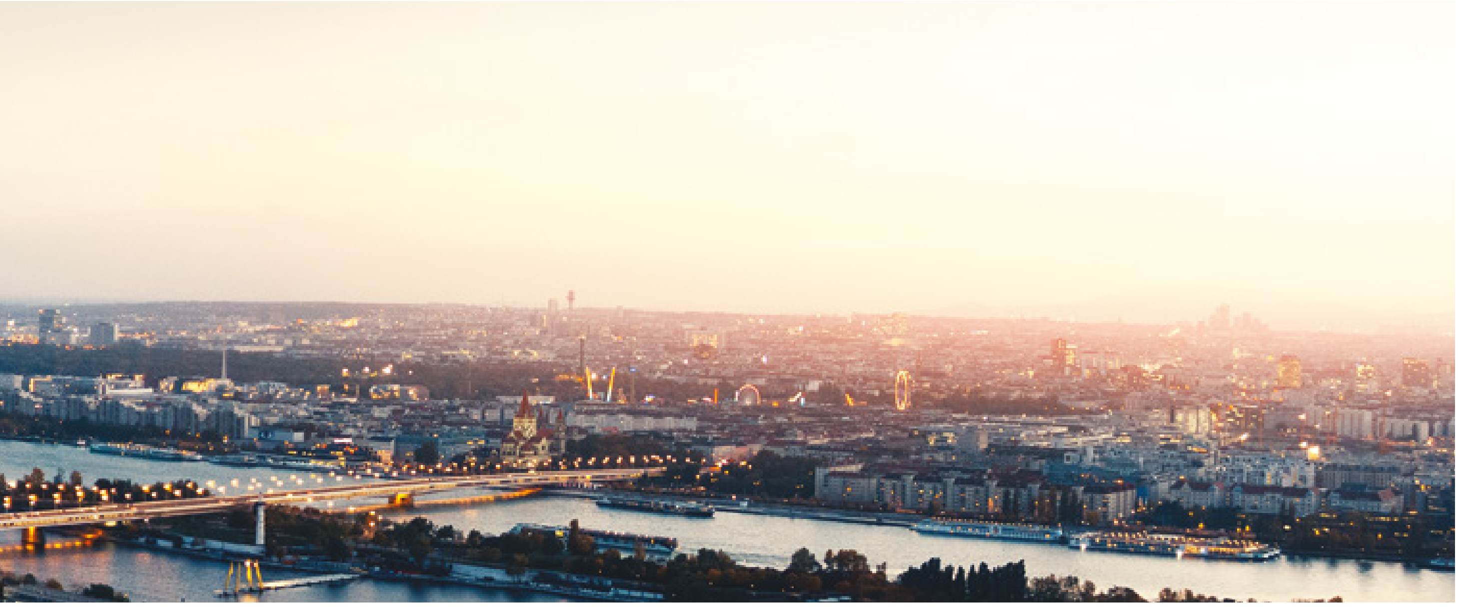
Besides, the disappearance of inflationary pressure in a situation of full employment gives greater value to monetary policy in that the latter is not defeated by a rise in inflation that would then have to be countered by raising rates.

In addition, the creation of currency areas with fixed exchange rates such as the Euro Zone also gives back some margin of efficiency to fiscal policy, which does not find itself neutralised by a loss of confidence in the currency, an increase of local interest rates or by an impact on inflation.

The coordinated policy mix that prevailed at the exit from the Euro Zone crisis in 2012 was mainly a combination of budgetary austerity and monetary expansion (one permitting the other). It had the merit of preserving the Euro Zone, but the results of which are debatable and call to question the efficiency of the negative interest rates and fiscal multipliers (a subject already highlighted in a section above).

A NEW REGIME WITH MORE COORDINATION

Today, the COVID-19 crisis once again raises the question of which tool should be favoured in this context of demand that is temporarily restricted by the lockdown measures (and which thus cannot react to monetary stimulus). More generally, the question is whether the effectiveness of the policy mix implies a close coordination, or if the credibility of economic policy requires independence and a separation of its two components:



- The sustainability of the sharply expanding public debt depends on the triple insurance of lasting low interest rates, the survival of the Euro Zone, and solidarity among the Euro Zone countries. We note in particular that it was the ECB's intervention at the end of March announcing a major increase in its sovereign debt purchases and flexibility in its capital key to buy peripheral debt that enabled the Italian spread to tighten;
- The credibility of the currency and the central bank requires a good balance between the insurance that the peripheral risk will remain contained by the central bank and the constraint that this central bank is not subject to the whims of the member states to have their debt monetised by the common monetary institution.

There thus exists without a doubt several policy-mix regimes depending on circumstances; in the crisis periods of 2008, 2011, and 2020 we therefore observe a much closer coordination of policies without this causing markets to worry about the credibility of the central bank or stress on the currency. In reality, the market appears rather to have tended to add a risk premium when investors doubted the ability or will of the central bank to intervene.

CENTRAL BANK INDEPENDENCE

The significant extension of the scope of intervention of the central banks raises the question of their reaction function and their independence, thereby reinforcing the notion of fiscal dominance.

The credibility of the central banks in the context of a highly coordinated policy mix and de facto monetisation of sovereign debt ultimately lies in the preservation of their independence on a statutory, budgetary, and decision-making level as well as a policy based on rules.

By statute, the president of the European Central Bank is designated by the heads of the Euro Zone governments, but the long (8 years) and non-renewable term of the ECB president is a form of guarantee of its independence. In the US, the chairman of the Federal Reserve (Fed) is appointed by the US president and reports annually to Congress. The question of the independence of the Fed was raised in the US in light of the many comments by Donald Trump about the monetary policy implemented. But despite this growing pressure and despite the crucial issue of the preservation of governments financing conditions, the central banks have succeeded rather well in managing their independence. Their increasingly greater role has tended to reinforce them *vis-à-vis* the more constrained governments subject to the vagaries of public opinion. In recent periods, through their discourse the ECB presidents have even been the ones to push European governments towards a more voluntarist action, and not the contrary.

In conclusion, the scenario that the COVID-19 epidemic takes us to is one of a policy mix that is highly coordinated, expansionist both in fiscal and monetary terms, and based very largely on the probable near-permanent monetisation of sovereign debt by the central banks.

POLICY-MIX IN THE EURO ZONE

The Euro Zone is a construction that has no real equivalent in the world in terms of policy mix: a shared central bank and a single currency, but essentially national fiscal policies, in the framework of a community treaty with a broader reach than the Euro Zone (the entire EU) and a common budget representing only around 1% of the GDP of the Euro Zone.

At the time of the creation of the euro, the hope was that the single currency would give Europe new economic leeway, following the currency crises at the start of the 1990s, which had led some countries to have to choose between supporting their currency (like France, at the cost of very high real interest rates and significant recessive effects) and supporting activity (Italy, Spain, Portugal), even if it meant having to accept a depreciation of exchange rates within the European Monetary System.

AN OPTIMAL CURRENCY AREA?

One of the benefits of a single currency area is to make the fiscal policy of a given country more efficient; when a country decides to implement fiscal stimulus, the ensuing rise in interest rates is lower as it is shared by the entire zone. This benefit nevertheless presents a risk of moral hazard behaviour labelled "free riding", which justified the establishment of the Stability and Growth Pact from the outset in order to provide a framework for containing the risk of imbalances in terms of public finances.

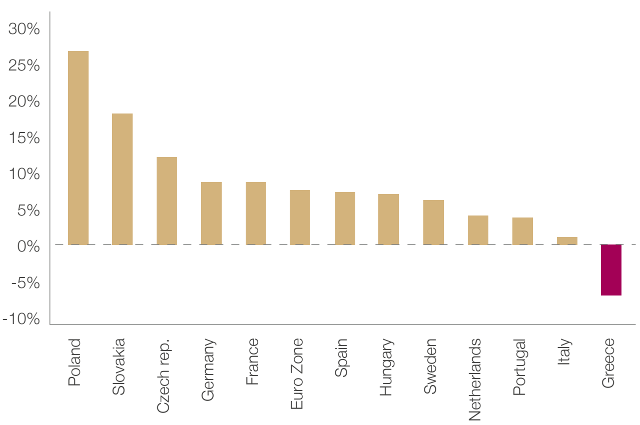
Moreover, for a single currency zone to work, there has to be a certain amount of convergence of the countries' cycles, to permit an adequate monetary policy for all of the countries in the zone. This convergence implies an "optimum currency area" (a notion identified by Mundell in 1961 and further developed by McKinnon in 1963) characterised notably by high mobility of capital and labour, a good level of diversification allowing for a certain level of economic convergence, and the capacity to limit asymmetrical shocks. The conditions of mobility were not met at the time of the creation of the euro; the construction of the single market over the past several decades has strengthened, with greater ability for people to work in other Member States. However, the fact is that the zone remains relatively fragmented, with essentially national labour markets, limited capital transfers (banks' balance sheets are especially invested in their country's assets), and increased industrial specialisation (e.g. the automobile industry).

CONVERGENCE OR DIVERGENCE?

The hope was that the adoption of a single currency and common budget criteria would create convergence, thereby enabling a coherent policy mix. This is undoubtedly what happened over the first decade of the existence of the euro.

The reality observed shows rather the opposite since 2008, as reflected in the gap between productivity ratios (Chart 6), trade balances, accumulation of asymmetrical shocks, and diverging debt-to-GDP ratios (Chart 7), leading to the return of sovereign risk in the Euro Zone among the southern European countries. We also saw that the absence of the possibility of exchange rate fluctuations among the countries in the zone could lead to a competitiveness gap and a permanent trade surplus (which is not reduced by a rise in the currency as would be the case under a flexible exchange rate regime); this is the case of Germany, where the trade surplus has increased substantially and which country has had a higher growth rate than France or Italy over the past decade.

CHART 6: CHANGE IN PRODUCTIVITY SINCE 2010, %



Source: OECD, Indosuez Wealth Management.

CHART 7: EURO ZONE ANNUAL GROWTH IN GDP, DEBT, AND DEBT-TO-GDP RATIOS, %

Source: IMF, European Commission, Indosuez Wealth Management.

Conversely, we also see that faced with an asymmetrical economic shock affecting a country or a group of countries of the zone, in the absence of flexible exchange rates, in order to regain competitiveness some countries are forced to adopt a policy of adjustment through prices and wages, which partly explains the deflationary pressure observed in the south of Europe in the 2010s. This situation made it difficult to determine a single monetary policy for the zone, and was partially resolved by the broadening of the ECB's means of action, as well as by the ability to adopt macro-prudential measures in some countries, for example to prevent the real estate market from overheating in France.

EXPANDING THE POLICY TOOLKIT

Today, the COVID-19 crisis represents a full-scale test of the Euro Zone's ability to respond with an appropriate policy mix to a global shock affecting all of the countries but with partially asymmetrical effects, with a much more violent outbreak in Spain and Italy and a greater economic impact in these two countries, resulting from more restrictive and longer lockdowns, precisely in the countries that have smaller budgetary leeway than in northern Europe.

This is what explains the wish expressed by the Italian government to activate the solidarity mechanisms introduced in 2012 and issue debt at the Euro Zone level.

In this context, the suspension of the Stability-Pact criteria is also a strong sign, demonstrating both the will to avoid penalising activity with devastating fiscal austerity, and to be able to respond more easily to the asymmetrical shocks linked to this pandemic. More broadly, this reflects a change - temporary or more structural - in the balance of power between the partisans of budgetary orthodoxy on the one hand, preoccupied with the moral hazard and fiscal sustainability, and the supporters of a more integrated and voluntarist economic policy.

The decision taken in April by the Eurogroup to launch a 540 billion euros support package is also significant; firstly because it shows that this crisis is probably the first time where the means deployed at the EU level are greater than at the national level, and secondly because we are now seeing the beginnings of a mutualisation of the debt, when a country is refinanced through the European Stability Mechanism.

FISCAL INTEGRATION AND SOLIDARITY IN QUESTION

However, these two elements remain far from a real pooling of debt: on the one hand because the amounts drawn are capped (at 2% of GDP for the ESM at this stage, i.e. around 35 billion euros for Italy, which is far from what is needed to fight the recession); on the other hand because the ability to use the funds outside the strict framework of the health aspect of the crisis is subject to conditions. This is what has led to a political debate in Italy and is at the origin of the European Recovery Plan that is currently being discussed.

Regarding the ECB, the intensification of its actions reflects the change in the policy mix of the Euro Zone, which is expansionary in both its fiscal and monetary components. The significant intervention of the ECB - whose balance sheet is set to increase by close to 1 trillion euros - equally targets explicit objectives that are common to the entire Euro Zone (ensuring the financing and functioning of the economy and market liquidity, maintaining confidence in the Euro Zone) and implicit objectives (limiting the widening of the spreads of the peripheral countries to make their debt sustainable and maintain confidence in the euro). For this purpose, it has given itself the ability (temporarily and limited to this pandemic) to acquire sovereign debt at a magnitude deviating from the capital key rule.

In conclusion, this pandemic constitutes a catalyst to accelerate certain changes in the European policy mix compared to the 2011 crisis, both in terms of tools and ambition. The decisions taken recently are unprecedented, but the political conditions nevertheless do not appear to be in place for the Euro Zone to embrace totally integration and budget solidarity. We thus can expect a multi-tiered exit from the crisis for the Member States and conclude that the Euro Zone will remain an incomplete currency area.

WHAT TO EXPECT IN THE WAKE OF THE PANDEMIC

The COVID-19 crisis is likely to change our world in many fundamental and lasting ways. Already existing trends could be accelerated and amplified and new trends might emerge as priorities and opportunities change.

MULTILATERALISM

The post-World War II period has raised living standards in the world like no other before it. Global poverty declined below 10% of the world's population – still too high, that much is certain – but nevertheless a truly exceptional feat. This stunning performance rested very much on increased international collaboration and openness, supported by a rules-based international order. This trend has been derailed, notably since the 2016 UK referendum on EU membership, and the election of President Donald Trump in the US. International mobility will struggle to recover, at least for as long as there is no vaccine against the virus. International trade too might be lastingly impaired as countries can be expected to build new, local, capacity in key areas in an effort to strengthen resilience and preparedness for potential future crises. It seems all but inevitable that the coming 30 years will bear scant resemblance to the past 30 years in terms of global economic performance and poverty reduction.

As regards the international institutional framework, it might not crumble. The US administration has withdrawn funding as well as its participation in major international organisations and groupings but other countries have more quietly continued to deepen their collaboration. The largest trade agreement ever was concluded in Africa last year, and when the US pulled out of the Trans-Pacific Trade Partnership, the other countries forged ahead undaunted. Approval ratings have recently punished more populist behaviour and rewarded more traditional statesmanship. How that might turn out at the ballot box remains to be seen, but a potential President Joe Biden might be more inclined to support existing international organisations. This would probably be the best possible outcome of this crisis, as the only effective and acceptable way to provide a check on super-power behaviour, although tensions between the US and China are likely to persist for years to come under any US administration.

LESS LEAN

In the search of efficiency, both the private and public sectors have tended to operate with thin margins in their production processes. Nowhere has the down-side of such strategies become more apparent than in the health sector. As reserves of essential inputs will have to be built up, as will buffers against future black swans, operating margins will likely be compressed. Moreover, the risks, now revealed, of relying on imports in certain areas of key strategic importance will most likely cause countries to shift some production to their domestic markets, and continue to modify supply chains in coming years. In this process, firms will have to tackle a starker choice between cost optimisation and the safe-guarding of the supply of inputs. Moreover, firms will likely have to address the rising pressure to not only maximise profits in the interest of shareholders, but also to incorporate the interests of other stakeholders in their future corporate strategic plans.

Not only does the private sector looks set to become less lean, but the public sector as well. The role of government has been shored up over time and rare are the cases when such trends are reversed. Where healthcare and social support systems will be permanently expanded, and where parts of the private sector might be rescued by governments and remain under public-sector control, the share of government spending in the economy can only grow. At some point it can be expected that taxes will have to rise. One particular debate in this context concerns some form of universal income. This can take many forms, and can actually involve efficiency gains if such measures streamline and replace what is often a multitude of income-support programmes. Some might argue that the cash handouts provided during the current pandemic are a step in this direction. At the very least, the necessity of such support today places the debate on the issue more in the mainstream. The upshot remains though, that more government and higher taxes will likely dampen long-run potential economic growth rates.

CLIMATE CHANGE

A positive side of greater government involvement could be a more persuasive response to the changing climate and the disasters it is already bringing with it. This too is a global crisis, requiring global solutions, but one from which it is impossible to self-isolate. Responding to climate change involves many of the above-mentioned actions in terms of building resilience and preparedness. It will necessitate large investments, new urban planning, potentially the relocation of entire communities, and raises urgent questions about food and water supplies. Possibly hundreds of millions of people will be on the move as their current homes become unliveable, and the havoc that the 2015 migration crisis wreaked in Europe will simply pale in comparison.

The current pandemic represents both a threat and an opportunity in this context. The threat involves, obviously, the challenge as to how to finance the investments needed in clean, resilient infrastructure given the exceptional government spending required to mitigate the economic impact of the virus. The OECD estimates that 95 trillion dollars of investments are needed over the 2016-2030 period in order to tend towards limiting the rise in temperature to something close to 2°C, and more still to actually meet or beat it. This would imply investments of around 6-7 trillion dollars per year, or approximately 7% of world GDP annually. Investments needed in transportation would consume 43% of the estimated total, and the energy sector would require 34%. Moreover, around 60-70% of the total would fall on emerging countries.

The opportunity lies in the possibility to develop a pricing model which better reflects the true costs to society. Regarding green-house gas emissions, two ways exist to establish a price for these. One is the emissions trading system (ETS) which establishes a market price for emissions, and the second is a carbon tax where the government sets the price. There is ample scope to expand these as only some 40 countries have them, together covering 13% of global annual emissions, according to the World Bank.

Similarly, in the transportation sector, the cost of transport does not reflect the full cost to society in terms of accidents, pollution, CO^2 emissions, etc. Most countries do tax all modes of transport but the taxes are weakly indexed on these external costs and cover them only partially. Fair pricing, covering all direct and indirect costs, likely leads to improved allocation of capital. On top of that fair price, the 197 countries who have signed the Paris Agreement on climate change could add a further tax to express the desired policy. This is obviously both complex and controversial in a world where 6.5% of world GDP is spent on energy subsidies, more than the 5.9% of GDP spent globally on education. Phasing out such subsidies and promoting fair pricing will necessitate offsetting support directly to vulnerable households.

OIL

Perhaps the COVID-19 crisis will accelerate the transition away from fossil energy. To be sure, the oil market has seen disruption on an epic scale this year when the oil price turned negative for the first time in history. Low oil prices are often seen as a threat to the energy transition because it makes it harder for alternative energy sources to compete. However, from an investor's perspective, the returns that can be expected from drilling for oil are now so low that investing in other forms of energy production can compare favourably. The fossil energy sector will not disappear overnight, but it is probably safe to assume that it will be forever diminished.

THE WORKPLACE

The most notable change is of course the adoption of working from home for those whose activities allow it. Offices will re-open, but working from home will not carry the same stigma as before. Several large companies have already signalled that they expect to reduce their office space and real estate holdings going forward, and a structural oversupply is to be anticipated. As for the gig economy, the insecurity faced by those without a fixed employer, as well as by many who do have or had one, will in all probability linger. How to provide health and safety to the self-employed and those in countries' informal sectors will be a key issue going forward, and one that might dampen the enthusiasm for such types of jobs. On the other hand, necessity is a force for innovation, and new trends are likely to emerge in this area which might as of yet be hard to imagine. One that is likely to strengthen is on-line education, and future recruiters will have to learn how to assess such qualifications.

CONSUMPTION PATTERNS

What people will buy though, might not be the same. Ostentatious consumption and luxury tend to decline in times of crisis. The way firms adapt their offering could well determine the trend. So too will in all likelihood customers' rising tendency to sanction certain corporate behaviour in social media, as well as in their consumption patterns. It is quite possible that the trend towards consuming in a way that supports the global sustainability goals becomes more generalised. The pandemic has certainly put a spotlight on the importance of the Environmental, Social, and Governance (ESG) issues that tend to be the focus of sustainable investing – an area that can only be expected to grow. Many services, including health services, have been provided on-line (Table 1) during the crisis and we expect this to continue. The prices of such services could fall, or at least rise less rapidly, prolonging the disinflationary influence that we have enjoyed in manufactured goods.

Many other areas of our lives will most likely feel reverberations of this crisis for years to come. However, previous crises have also led many to believe in a new world coming, only for reality to fall short of expectations. To be sure, this time might be no different as change tends to be costly, also politically. Nevertheless, human ingenuity in the field of technological and social innovation can possibly be relied upon to help our global economy face the structural challenges that lie ahead.

TABLE 1: INTERNET USAGE DURING THE PANDEMIC, %

Type of usage	Change versus pre-COVID-19 typical day
Gaming	115
VPN	49
Video	36
Downloads	39
Web	27
Social	-12
Voice minutes of use	25

Source: Verizon, The New Stack, Indosuez Wealth Management.

Alps, Switzerland

MACRO-ECONOMIC OUTLOOK

THE WORLD ECONOMY IN CRISIS

Vocabulary fails to capture the extra-ordinary experience of fighting a global pandemic with a “voluntary” shut-down of large parts of our economies. For macro-economic forecasters, the situation has rendered past data irrelevant, and various estimates span ranges 10 percentage points wide or more, to which we must add exceptional margins of error. Hence, any scenario must be appreciated in this context, and taken with a bucket, rather than the habitual pinch, of salt.

Our scenario is dramatic, and at the same time a best case. It makes the following key assumptions:

- Most confinement measures are progressively removed in Q2;
- The rebound expected in the second half of the year is a rather modest one, relative to the extent of the contraction anticipated in the first half;
- The price of oil will struggle to exceed USD 30/barrel this year, on average, which is supportive of the global business cycle, all else being equal;
- Oil-price deflation will dominate the inflation outlook which is thus disinflationary;
- The euro-dollar exchange rate is expected to evolve between USD 1.05 – 1.15/EUR in 2020, and is considered neutral with respect to our scenario in this case.

In this case, we expect the global economy to contract by 3% on a full-year basis this year, while 2021 should deliver a 5.5% expansion in global GDP (Table 2). In terms of quarterly evolutions (QoQ), China’s contraction of 9.8% QoQ in the first quarter is a pointer to what we can expect to see in most mature economies in the second quarter. Our forecast concerning the rebound in subsequent quarters is more U-shaped than V-shaped. Indeed, our expected 5.5% world GDP growth rate in 2021 is comparable to that seen in 2010 (5.4%) which followed a much milder contraction of 0.4% in 2009 than the -3% or worse that we might see in 2020, underscoring the relative weakness in our anticipations.

Should our assumptions prove to be erroneous, the expected outcome becomes radically worse. If the crisis lingers and containment measures are not lifted, or are re-imposed later this year, world GDP could contract by 6% this year. In the eventuality of a heightened pandemic next winter, the contraction could be as large as 9% or worse still. All of these outcomes are possible, but based on China’s experience,

TABLE 2: MACRO-ECONOMIC FORECASTS PER COUNTRY, % AND PERCENTAGE POINTS

	2019		2020		2021			2019	2020	2021
	GDP	CPI*	GDP	CPI*	GDP	CPI*	PPP weights (2018)	Contributions	Contributions	Contributions
World	2.9	-	-3.0	-	5.5	-	100	Pct points	Pct points	Pct points
United States	2.3	1.8	-6.0	0.8	4.5	1.7	15.2	0.35	-0.91	0.68
Japan	0.7	0.5	-5.0	0.0	3.0	0.3	4.1	0.03	-0.21	0.12
United Kingdom	1.4	1.8	-6.5	0.9	3.8	1.5	2.2	0.03	-0.15	0.09
Euro Zone	1.2	1.2	-7.5	0.4	4.6	1.0	11.4	0.14	-0.86	0.52
Germany	0.6	1.4	-7.0	0.5	5.0	1.2	3.2	0.02	-0.22	0.16
France	1.3	1.3	-7.2	0.5	4.5	1.0	2.2	0.03	-0.16	0.10
Italy	0.3	0.7	-9.0	0.0	5.0	0.7	1.8	0.01	-0.16	0.09
Spain	2.0	0.8	-8.0	-0.1	4.0	1.0	1.4	0.03	-0.11	0.06
Switzerland	0.9	0.4	-6.0	-0.5	3.8	0.3	0.4	0.00	-0.02	0.02
Brazil	1.1	3.7	-5.8	1.6	3.5	3.1	2.5	0.03	-0.15	0.09
Mexico	-0.1	3.6	-6.3	2.5	3.2	3.0	2.8	0.00	-0.18	0.09
Argentina	-2.2	53.5	-7.4	50.0	3.7	40.0	0.7	-0.02	-0.05	0.03
Russia	1.3	4.5	-6.8	3.1	4.0	4.0	3.1	0.04	-0.21	0.12
India	4.2	3.7	2.0	3.3	7.4	3.9	7.7	0.32	0.15	0.57
China	6.1	2.9	2.0	2.5	8.3	2.1	18.7	1.14	0.37	1.55
Asia ex China, India, Japan**	4.8	2.1	-1.0	1.8	8.0	2.7	7.9	0.38	-0.08	0.63

*Consumer Price Index. **Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam.

Nota Bene: World GDP is PPP (Purchasing Power Parity) and on a full-year basis. Contributions are growth rates multiplied by the weight of the country/region in world GDP, expressed in percentage points.

Source: Bloomberg, IMF, Indosuez Wealth Management.

and on the re-opening plans being issued as we write these lines, we regard our scenario as the most likely outcome at this stage. The risks seem overwhelmingly concentrated on the down-side, and an upside surprise is difficult to imagine.

We do not expect the Fed or the ECB to cut policy rates further this year (Table 3). The cuts that the Fed has already delivered will make it possible for other central banks to reduce their policy rates in line with our anticipated drop in inflation, conditional upon the absence of any excessive US dollar strength.

Global trade in goods could shrink by 10-30% this year, and a figure closer to the former has been retained for our scenario. For comparison, trade volumes fell by around 10% in the Global Financial Crisis, and by some 60% in the Great Depression. A majority of countries will likely see their current account balances deteriorate. Oil exporters' surpluses will shrink, and most oil importers' lighter energy bills will probably not be apparent given the generalised drop in trade volumes. This could cause balance-of-payments crises in countries with insufficient reserves and this risk is mostly concentrated among low-income countries. It is important to note the good news at the margin here, which is that we entered the COVID-19 pandemic with much smaller current-account imbalances in general than in 2008 when these were part of the underlying causes of the crisis.

Unemployment will rise rapidly to levels rarely seen in past crises, but by more or less depending on the social security system in each country. Fiscal support measures aim to replace lost income in all countries, never mind the channel adopted for its disbursement. Indeed, should funds fail to reach the persons concerned, the recovery will be slower and lower. Re-hiring will be a challenge to be sure, and will depend critically on to what extent the fiscal support directed towards enterprises of all sizes will manage to prevent bankruptcies. Indeed, it might well transpire that the European response consisting in helping companies financially in order to maintain staff on the payrolls will prove more efficient in this context than the US' strategy of sending checks to the rising numbers of unemployed. Potential failures in the implementation of the vast fiscal and monetary support provided in this crisis is a major risk to our scenario.

On the fiscal side, roughly half of the support packages provided by various countries can be expected to be returned as it comes in the form of loans. In spite of this, government deficits will likely double or worse in percent of GDP, and the debt-to-GDP ratios are likely to set new highs. The US general government budget deficit could rise from nearly 5% of GDP in 2019 to well over 15% this year. The euro area's is likely to go from 0.7% of GDP last year, to around 7% this year. China's deficit is also set to swell, from 6.5% in 2019 to over 11% in 2020. Uncertainty is great regarding these numbers as well, because new support packages keep being rolled out. As for the debt levels, the US gross general government debt-to-GDP ratio is likely to rise from 109% in 2019 to over 130% by the end of this year. Italy's will in all likelihood exceed 155% of GDP, and Japan's could exceed 250%.

TABLE 3: CENTRAL BANK POLICY RATES, 2020-2021 FORECASTS, %

	Dec. 2018	Dec. 2019	Dec. 2020	Dec. 2021
Argentina	59.00	55.00	35.00	45.00
Australia	1.50	0.75	0.25	0.25
Brazil	6.50	4.50	2.25	3.25
Chile	2.75	1.75	0.40	0.60
China	4.35	4.35	3.50	3.50
Euro Zone	0.00	0.00	0.00	0.00
India	6.50	5.15	3.50	3.70
Indonesia	6.00	5.00	4.00	4.10
Japan	-0.10	-0.10	-0.10	-0.10
Malaysia	3.25	3.00	1.75	1.95
Mexico	8.25	7.25	4.00	4.30
Philippines	4.75	4.00	2.45	2.65
Russia	7.75	6.25	4.70	4.70
Saudi Arabia	3.00	2.25	1.00	1.00
South Africa	6.75	6.50	3.40	3.50
South Korea	1.75	1.25	0.50	0.60
Switzerland	-0.75	-0.75	-0.75	-0.75
Thailand	1.75	1.25	0.40	0.40
Turkey	24.00	12.00	8.00	9.00
United Arab Emirates	2.75	2.00	0.75	0.75
United Kingdom	0.75	0.75	0.10	0.10
United States	2.50	1.75	0.25	0.25

Source: Bloomberg, Indosuez Wealth Management.

Rayong, Thailand

For the Euro Zone, it could grow from nearly 85% in 2019 to around 97% this year. China's debt-to-GDP ratio could climb from 55% to 65%. Unfortunately, the world economy entered the current crisis in worse shape than on prior occasions as global debt was already at an all-time high in 2019. This will be a defining feature of our world post-COVID-19 and one that will most likely be addressed by a prolonged period – likely decades long – of negative real interest rates (Chart 8).

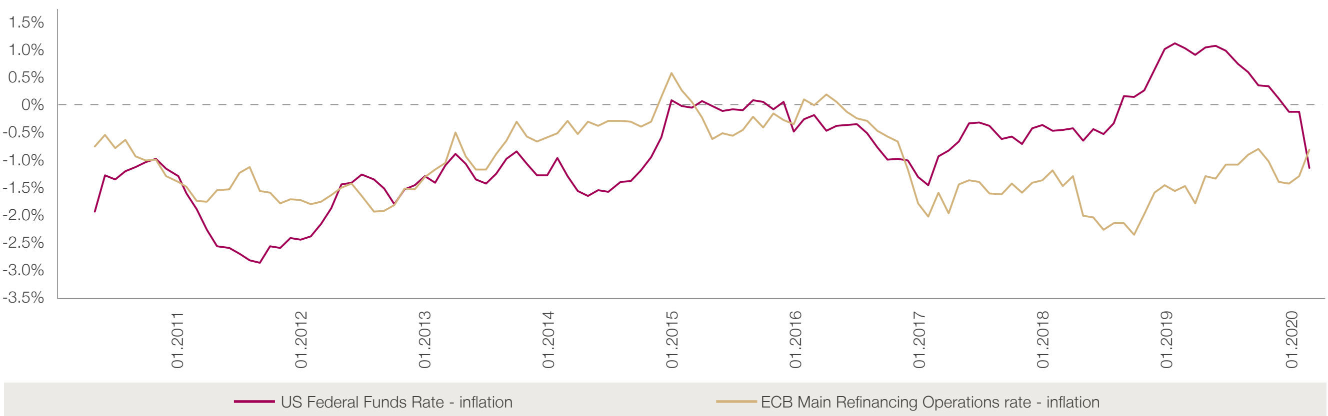
Central banks engaged in quantitative easing will see their balance sheets grow to historic highs. The debt burden will put constraints on how monetary policy can be articulated and it is another lucky circumstance that the structural forces that help keep price increases in check, notably the technological revolution, will in all likelihood continue to dominate the cyclical forces for years to come. Moreover, the tolerance for any overshooting of inflation targets will in all probability be high and therefore also limit the expected response in policy rates. The situation will likely necessitate more explicit collaboration between central banks, treasury departments, and public debt-management offices than we have been accustomed to in the era of central bank independence, and could be problematic in countries with lower levels of trust in public institutions.

All in all, this historic policy response to the global pandemic should, if destruction of productive capacity is successfully curtailed, allow for the drop in output to be recuperated towards the end of 2021. Should more widespread business failures occur, this crisis could morph into a more classical, and longer-lasting recession.

In sum, during the years ahead, we can expect our global economy, post COVID-19, to be characterised by:

- Slow growth;
- High debt;
- Low inflation;
- Low nominal interest rates;
- Negative real interest rates.

CHART 8: FEDERAL FUNDS AND ECB RATE, %



Source: FactSet, Indosuez Wealth Management.

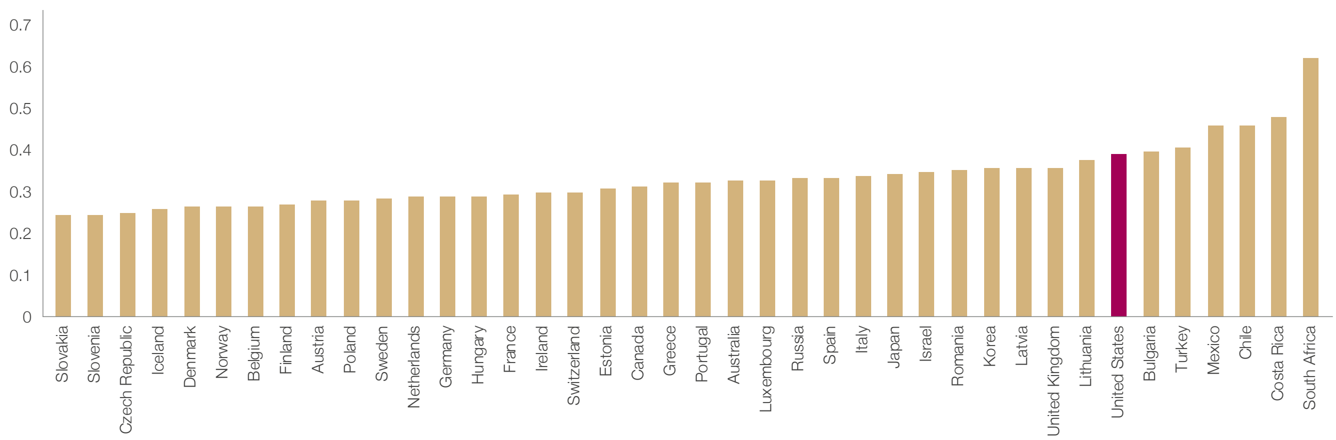
In the midst of a global pandemic, other fundamental problems in the economy fade into the background, and rightly so. They do nevertheless remain very much present and need to be addressed when possible. One structural problem in the US economy is the issue of the twin deficits, i.e. a government budget deficit coupled with a negative balance also on the current account. As regards the budget, it has been in deficit since 1970, with the exception of the years 1998-2002. The largest deficit since 1970 was recorded in 2009 at 10% of GDP. It moderated over the following years, but started to rise again in 2016. This year it could approach 20% of GDP, depending on potential forthcoming additional support packages. The Congressional Budget Office issued new projections as per 24 April 2020, putting the deficit-to-GDP ratio at 17.9% in 2020, and at 9.8% in 2021. The federal debt held by the public is expected to hit 101% of GDP in 2020, and 108% in 2021.

Of course, this eye-watering increase is mostly linked to the response to the pandemic. However, the fundamental disequilibrium in the US' state finances is a persistent problem. The rest of the economy too tends to lend itself to overconsumption as evidenced in the fact that the US runs the largest current account deficit in the world, in US dollar terms (the UK has the second largest). Thanks to the large size of US GDP, this translated into a current account deficit of a rather modest 2.3% at the end of 2019. The average ratio since 1960 is -1.6% with a low set in 2006 at nearly -6% and the largest surplus over the period was in 1975 at 1% of GDP. Hence, we can conclude that the US is an economy that tends to spend beyond its means, both in the broad economy and in government. This necessitates importing capital from abroad to help finance these deficits. For most other countries that can prove untenable, leading to balance of payments crises and large currency depreciations with the associated inflationary impact. The US, on the other hand, is often spared any fallout from its profligacy, very much thanks to it benefitting from the "exorbitant privilege" of being the issuer of the world's reserve currency, to quote Barry Eichengreen. Nevertheless, foreign ownership of Treasury debt has declined from 47% in 2009 to 41% in 2019. Japan and China now own 7% each, down from 10% and 12% respectively in 2009. Hence, not even the US is completely immune to waning foreign demand for its assets and the twin deficits are an important, and growing, structural problem in the US economy.

TRADE

The Trump administration has arguably attempted to address the current account – or trade deficit, by waging a trade war on principally China. If the trade deficit is a result of consuming beyond one's means, we readily understand the limitations of trying to solve that issue through any bilateral trade policy. The most efficient means to address the trade deficit would be to raise taxes in the US, whereas the country took the opposite decision in 2017. Of course the success of eliminating the trade deficit through higher taxes depends on how necessary those imports are and whether they are judged essential even in the face of reduced purchasing power. Nevertheless, tax increases tend to depress demand and reduce imports while tax cuts do the opposite. It must be said too that the 2017 tax cuts worsened the income distribution in the US which had already returned to the levels of inequality last observed in the late 1920s. As can be seen in Chart 9, this is a problem that the US does not share with other major developed economies, and it is one that has deep societal consequences, including the increased desire for protectionism.

CHART 9: GINI COEFFICIENTS, 2019 OR LATEST



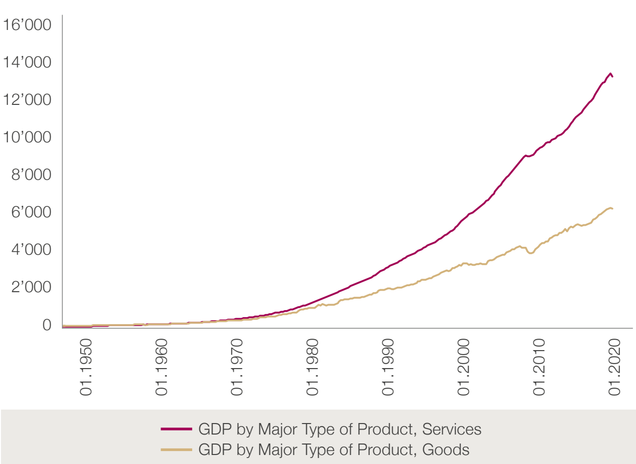
0=perfectly equal, 1=perfectly unequal
Source: OECD, Indosuez Wealth Management.

Tariffs pose a similar dilemma to tax increases in that if the affected imports benefit from price-insensitive demand (such as medicines), the trade deficit can actually grow as protectionism rises. This seems to have been the case at least until December 2018 when the trade deficit hit a local low of USD 61 billion from which it has since improved somewhat. New threats have been issued on the trade front and this is likely to remain a feature of the existing US administration during its time at the helm. Trade has now been decimated by the pandemic, but longer term the protectionist threat to the US and the world economy persists.

SERVICES VERSUS MANUFACTURING

The "Make America Great Again" slogan taps into an unease about another structural development which is the perceived decline of the manufacturing sector. We say perceived because manufacturing output has grown with only few interruptions ever since the sector was overtaken by services in the late 1950s (Chart 10). To be sure, the share of manufacturing in the economy has dropped below to 11% in the US and below 20% in most mature economies, but by the service sector growing more rapidly than manufacturing, not because of a decline in manufacturing. By the same token, the world economy is now around 65% services, and even China's service sector is larger than its manufacturing sector. It is interesting to note that the US has a surplus on its services trade balance, although it is dominated by the deficit in the trade in goods, and it would most likely make America greater still if it were to emphasise this particular strength.

CHART 10: US GDP PER SECTOR, USD BILLION



Source: FactSet, Indosuez Wealth Management.

Of course, looking at the sectors from the employment perspective paints a rather more depressing picture for the manufacturing sector. Manufacturing jobs rose from 9 million in 1939 to a high of almost 20 million in 1979 since when the trend is down, mostly because of technological efficiency gains. The sector's employment was of course heavily impacted by the 2008 crisis and it fell to 11.5 million in 2009 and improved thereafter to reach 12.4 million in 2016.

The recent high was 12.9 million in November 2019, and 500'000 jobs had thus been added during the Trump administration. The pandemic brought the number down to 11.5 again in April 2020, and further declines are to be expected. Meanwhile, jobs in the private services-providing sector swelled from 14.9 million in 1939 to 108 million in February 2020, before plummeting to 90.6 million in April 2020. The unemployment rate rose to 14.7% in April and will likely climb further before possibly returning to a single-digit number around the end of the year. Returning towards the 3.5% rate seen in February 2020 will, however, be a much longer process.

INVESTMENT

Business investment represented almost 11% of US GDP over the period 1948-1975. It rose to 13% of GDP in the subsequent years to 2019, but exceeded 15% in the 1980s. In terms of growth in investment, it took a hit in 2009, falling by 21.2% at a seasonally adjusted annualised rate, and rebounded by 14.1% in 2010 – a pointer as to what is likely in store in 2020-2021. Since 2010, however, it has gradually fallen to a still positive 1.8% in 2019 which year nevertheless posted three negative quarters. Money is generally speaking not a problem. Many large firms are flush with cash, or were before the pandemic, and interest rates are very low. Moreover, the household savings rate in per cent of disposable income, is reasonably high. A recent low was seen in 2010 at 5.7% and since then it has averaged 7.4%. With the advent of the pandemic, it shot up to 13% in March 2020. Hence, before the pandemic, many companies preferred buying back their own shares or buying other companies rather than engage in expanding investment. Both preferences tend to be positive for share prices, but are not necessarily helpful for the economy as a whole.

Washington DC, United States

DECLINING COMPETITION AND LABOUR MOBILITY

Mergers can lead to a lack of competition and this is a problem in the US – and also elsewhere – where the number of firms listed on America's stock exchanges has fallen from 8'090 in 1996 to 4'397 in 2018. Fewer firms thus dominate each industry and arguably benefit from a degree of monopolistic pricing power which shareholders like but which tends to dampen economic performance. Share buy-backs too drive stock prices higher thanks to the relative scarcity factor but not thanks to any particular achievement on behalf of the firm in question. This spells a trend decline in US competitiveness in absolute terms.

US labour mobility has been in decline since the mid-1960s and is now comparable to that in Europe but for the language factor. It has fallen because of a significant increase in professional licencing requirements on the state level which hinders inter-state mobility. Healthcare is also a factor and when provided by the employer it is something many wish to hang on to. House prices too have an impact on mobility, by discouraging moving to areas where they are high, but also by encouraging moves to areas with more affordable housing. Housing is now the number 1 reason in America for moving.

FRAUGHT POLITICS

Political dysfunction has risen in part as a result of the striking Supreme Court ruling in 2010 (Citizens United versus Federal Electoral Commission) which basically lifted all restrictions on political donations made by corporations, unions, and individuals. Voting districts have been gerrymandered into virtual single-party districts, and voter registration is often rendered impossibly complicated. The US' voter participation is around 60% in presidential elections, as a share of the voting eligible population. This is below the 70% average of OECD countries. Some of this dysfunction has been evident in the country's response to the pandemic.

A global pandemic requires a globally coordinated response. At the very least, it requires a centrally directed effort in each country. Even in a federation, this is entirely feasible, as we have seen in Germany, for example. The US under the current administration has no inclination to shoulder the role of global coordinator which the country did during past health crises such as AIDS or Ebola. No other super-power has stepped up to the plate, although China increasingly might see itself in that role, particularly if a vaccine were to be developed first by its scientists. Feeling that threat, the US decided to withdraw funding for the World Health Organisation in the midst of the crisis, citing pro-China bias on behalf of the de facto principal global health response coordinator. If this is to be the template for future super-power behaviour, we can only recall the 1920s and the ensuing years when events were very much driven by perceived national self-interest.

An alternative scenario is possible. Populations might draw the conclusion from this pandemic that the job of running countries and responding to global crises is a serious one, requiring experienced leaders. The UK seems to have taken steps in this direction with the election of the new Labour Party leader, and a change is noticeable in Prime Minister Boris Johnson's demeanour. The key question is of course what might happen in the US election due on 3 November 2020.

Much uncertainty surrounds this event including the issue of how it might actually occur. Although the presumptive Democratic candidate for the presidency is now Joe Biden, the party congress has been postponed to August and even that date cannot as of yet be confirmed. Logistics aside, Donald Trump's re-election is not a certainty. A significant difference with respect to 2016 is that the Democratic party is coalescing around Joe Biden in a way that never happened around Hillary Clinton. Most of Bernie Sanders' supporters spurned Hillary Clinton in that election while this time around the leaders of the Democratic Party's left wing are endorsing Joe Biden. A united Democratic Party poses a significant threat to Donald Trump's re-election.

National polling in April shows Joe Biden beating Donald Trump with a margin ranging from 4% to 11%. Hillary Clinton won the popular vote in 2016 by a margin of 2%. It is difficult to translate national voting preferences into electoral votes, but it is likely that Joe Biden would have to win the popular vote by some 5% or more in order to capture a majority of the electors. Voter participation will hold the key to the outcome, and this is difficult to predict in our COVID-19 times. Persons aged 18-29 years increased their participation in 2016 but it remained low relative to those aged 65 years or older: the participation rate of the former was 46% versus 71% for the latter.

President Trump's approval rating overall stood, on average, at 43.6% in April, down from nearly 46% a month earlier. This is above his term-average of 40 but below the average for all American presidents since 1938 of 53%. Amidst the political polarisation, Americans are rather united in their views of the response to the pandemic. Pew Research Center found 66% of respondents thinking Donald Trump is re-opening the economy too early, 65% think he was too slow to respond to the crisis in the first place, and 61% think that Donald Trump's information regarding the crisis is inaccurate.

CHANGING VIEWS

Attitudes have evolved on other key policy issues as well. Support among Americans for free trade has risen to 56%. As many as 67% support immigration. And 54% are in favour of the federal government providing a national health plan for all. Polarisation is still high, with 63% saying the nation is divided, but this is down from 76% in September 2019. How this will influence the result at the ballot box is unclear, but a victory for Donald Trump should not be taken for granted.

What might America's policy stance look like under a potential President Joe Biden? Here we list a selection of measures that he is in favour of:

- Raising the minimum wage to USD 15 per hour;
- Paid family and sick leave;
- Debt relief for students;
- Boost teachers' pay;
- Tax carbon emissions;
- End new oil and gas leases on federal land;
- Expand the Affordable Care Act;
- Pay for infrastructure investments by raising corporate taxes (while leaving them below the pre-2017 rate) and taxes on the wealthy;
- Increase the capital gains tax;
- Boost the defence budget;
- Investigate if anti-trust action needs to be taken in the technology sector;
- Do not use tariffs against countries;
- Join the CPTPP (the Trans-Atlantic trade agreement from which the US withdrew);
- Remove the right to spend unlimited funds in political campaigns.

Whatever one might think of such policies, they are globally less business friendly than those of the current administration. They would also likely swell the size of government in the economy, and further policies addressing resilience and preparedness for future crises will presumably be added (such as boosting health workers' pay). Many of these policies would benefit the economy in the long run by, for instance, improving income distribution, but what is good for the economy fundamentally is not always supportive of stock-market performance in the near term, and vice versa. The outlook for the US economy and its financial markets hinges critically on the outcome of the 2020 election, not only in terms of the presidency, but of course also in terms of the majorities in congress. If Joe Biden were to win the presidency but the Democrats fail to capture a majority in the senate, passing legislation on any of the points mentioned above will prove difficult. Flipping the senate majority is possible but still difficult. Democrats need to win 4 new seats and 4 states are currently rated as toss-ups, meaning the party would have to win them all. Without such an outcome, only a profound renewal within the Republican Party will allow much progress on Joe Biden's list of things to do.

CHINA AND THE ASIA-PACIFIC REGION

China has contributed roughly one third of the growth seen in the global economy in recent years. Last year it was responsible for 1.14 percentage points of the world's 2.9% GDP growth. This year, its contribution will likely fall to 0.37 percentage points. This is in absolute terms a much better performance than the negative contributions we are expecting from the US and the Euro Zone, but the magnitude of the decline will be greater in China than in the other economic powerhouses in the world, on this measure.

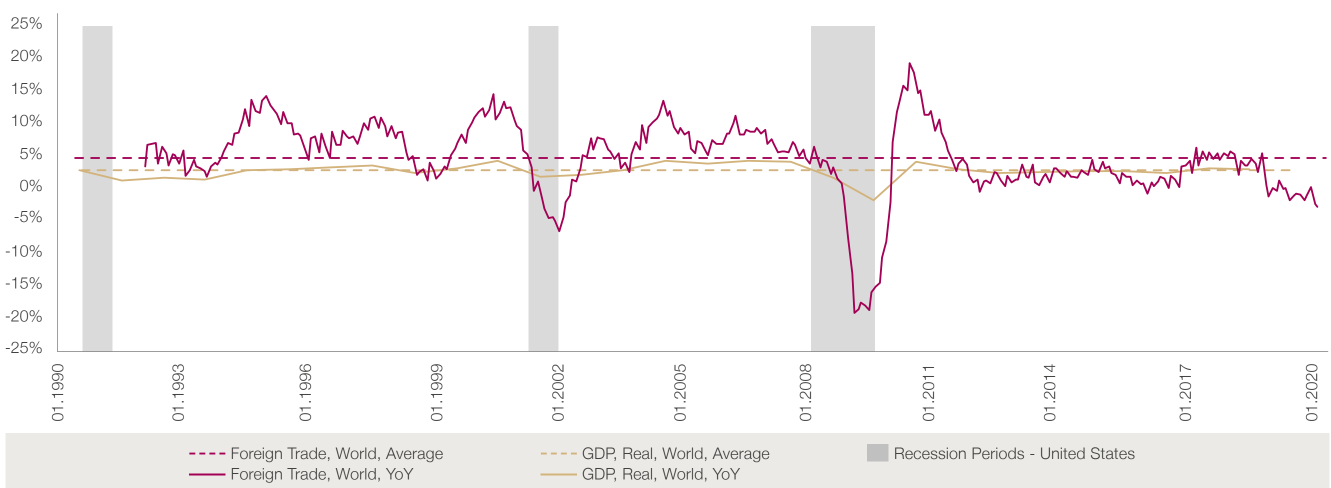
When China (briefly) enjoyed a GDP growth rate of 15%, the size of the economy was much smaller. Over the time it has taken for China's growth rate to decline to 6% in 2019, the size of the economy has more than doubled. As a result, China contributed more to world GDP growth at the lower growth rate than it ever did during its period of rapid growth. The COVID-19 crisis put a stop to that, but it is important to note that China and India are the only two countries likely to make a positive contribution to world GDP this year according to our forecasts. When some normality returns to the global economy, we can expect China to return to its path of rising economic heft coupled with a trend-decline in the GDP growth rate. We can imagine its growth rate to reach, potentially, 2% towards the middle of the century by which time the country is likely to be the world's largest economy. Its weight could rise from 18% currently to 20% in 2050 (based on purchasing parity according to a PWC study from 2017).

Over the same period, India's weight could more than double, from 7% today to 15% in 2050, making it the world's second-largest economy. The US would find itself in third place with its share of the global economy declining from 16% to 12%, and the EU could see a drop from 15% today to 9% over the coming 30 years. There is no doubt that most of the growth in the future will come from Asia.

Declining shares do by no means declining growth or declining wealth. It just means that other countries are growing faster. Nevertheless, the rise of China causes much anxiety among the countries whose relative importance is challenged, not only in economic terms but also in terms of the political influence that tends to come with greater economic might. These trends were already starkly visible before the COVID-19 crisis as the US administration in particular has illustrated with its self-imposed trade war (Chart 11). Today it is more difficult than ever to predict the global balance of power because the verdict on super-power behaviour during the crisis will take time to emerge, as will the final assessment of the economic fall-out.

In 2017, President Xi proclaimed that China was now in the "driving seat" regarding international affairs and would be "moving closer to centre stage and making greater contributions to mankind". What that actually means is debatable though the country has been hesitant in living up to those words in the current crisis.

CHART 11: GLOBAL TRADE VOLUMES AND GLOBAL GDP, %, AND AVERAGES, WITH US RECESSION PERIODS

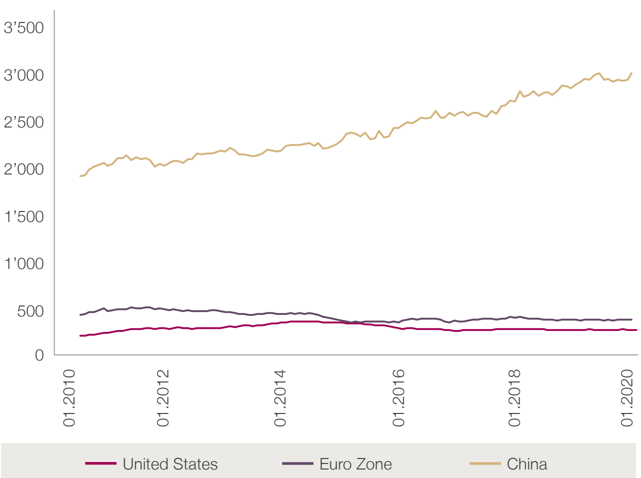


Source: FactSet, Indosuez Wealth Management.

Beijing, China

A further preoccupation regarding China is the stability of its financial system as the countries' total debt level has reached 300% of its GDP (including household, corporate, and government debt; Q1 2019, Institute of International Finance) – a number that also helps explain the rather more tepid fiscal response to the COVID-19 crisis in China compared to countries in the West. While it can be assumed that many Chinese banks have issues with non-performing loans, the largest banks are owned by the state and lend mostly to state-owned companies. With its USD 3.06 trillion in foreign exchange reserves, no other country in the universe comes close to China's war chest with which to combat a financial crisis (Chart 12).

CHART 12: FOREIGN EXCHANGE RESERVES: CHINA, US, AND EURO ZONE, USD BILLION



Source: FactSet, Indosuez Wealth Management.

Moreover, while the interest rates offered on deposits and charged on lending have been liberalised, they offer high margins and shore up banks' profitability. In addition, most of China's debt is issued in local currency and owned by domestic investors, further reducing the risk of a financial crisis in spite of the high debt level.

South Korea held election on 15 April and the ruling party of President Moon Jae-in, Minjoo (Democratic), won an unprecedented victory yielding 180 seats in the 300-seat National Assembly, up from 123 seats previously. This nevertheless falls short of the 2/3 majority needed to pass constitutional reform but it will end the parliamentary gridlock.

Japan's Shinzo Abe, on the other hand, will see his mandate expire in September 2021. He became Japan's longest-serving prime minister in November 2019 and his party majority has made Japan stand out as a relative haven of peace recently while many other mature economies have seen significant political transformations. It would require a modification of party rules for him to be able to remain at the helm beyond September. Judging by recent polling, there is not overwhelming support for such a prospect, and a change in leadership could spell a period of less stable government past the September 2021 election. Meanwhile, Japan's policy-mix has been very active in the context of the crisis, with one of the most important fiscal responses relative to GDP, a better capacity to control the pandemic, and a central bank that has announced limitless purchases of government debt.

RISING POVERTY

Australia has had a phenomenal 28 years of positive GDP growth which is now coming to a brutal end because of the global pandemic. With an economy dependent on China and on commodities, the country's performance will obviously be linked to the evolution in those two areas.

India is grappling with a shut-down in its 1.3 billion people economy where the World Bank estimate that over 75% of workers were in the informal sector in 2018. Such workers are not receiving any salary, compensation, or sick leave for the most part. The government has passed a USD 22 billion relief package, and the Reserve Bank of India has provided USD 63 billion in liquidity in addition to cutting rates. Many targeted measures have been introduced, including food aid, farm support, INR 1'000 for vulnerable households, collateral-free loans, insurance cover for health workers, and relaxed rules on bankruptcies. The challenge is enormous to protect the millions who live in crowded slums. It might be a blessing that 80% of the population is younger than 44 years old and could therefore be expected to suffer milder symptoms from the virus, but increased testing has seen rising numbers of infections and the lockdown period has been extended. The fact that the population is so young is also a particular challenge. As many as 1 million young persons enter the job market each month, and it would normally require the economy growing at a pace of 8% per annum to absorb them all. As is the case for many economies, the pressure to do more on the fiscal side is strong, but could require additional monetary action in order to control debt-servicing costs, and could increase the risk of rating agencies downgrading the country.

Developing countries in Asia have rolled out COVID-19 support packages to the height of 3.7% of GDP, versus a global average of 11% (ESCAP). General government budget balances which were -6% of GDP in Asia in 2019 look set to deteriorate to 10% of GDP in 2020. Currency risk is an issue in the region as a result of the policy accommodation and general risk aversion. Many currencies in Asia have depreciated by around 5% year-to-date (YTD) against the US dollar, which nevertheless pales in comparison to some commodity-based economies' roughly 25% depreciations YTD. Fundamentally, countries with current account deficits are likely to sport trend-depreciating currencies. Some relief on that score will certainly come from the low oil price as most Asian economies are net importers of fossil fuels.

The IMF, the World Bank, and the Asian Development Bank have pledged billions of dollars' worth of aid, the G-20 has granted grace periods for low-income countries' debt repayments, and more assistance is likely to come. Nevertheless, as the developed world moves to ease confinement measures, worse is surely to come in the developing countries.

The World Bank predicts that Sub-Saharan Africa will be hit the worst, not necessarily in terms of the number of COVID-19 cases, but in terms of the rise in poverty. Global poverty is set to rise this year for the first time since 1998 with potentially an additional 50 million persons falling into extreme poverty this year.

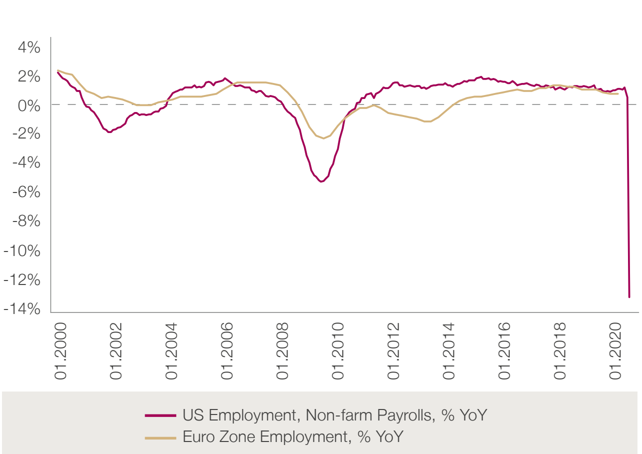
Melbourne, Australia

EURO ZONE

The Euro Zone grapples, pretty much since inception, with a pervasive perception that the monetary union is doomed to fail at some point. That rests on important work conducted in the 1960s by Robert Mundell, to name one, on the topic of optimal currency areas. The insights that still linger are that monetary unions require fiscal transfers within the union, and this all the more so if labour mobility is low within the union. Obviously, the world has evolved in the 60 years or so since. Intra-EU labour mobility has doubled since 2000 while in the US the Census Bureau reports that job switches declined by 25% between 1997 and 2013. Factors that contribute to more Americans staying put are the increase in professional licencing requirements which tend to be issued at the state level and thus discourage inter-state mobility; the cost of health insurance which encourages staying with an employer who provides it; and house prices which can both promote and prevent a move. The difference today between the US and Europe in this regard essentially boils down to language barriers. Moreover, the Euro Zone's record on employment is comparable to that of the US, given the fact that Europe had a second crisis in 2011-2012 from which the US did not suffer (Chart 13).

A fiscal union would nevertheless undoubtedly strengthen Europe's monetary union. However, the US monetary union survived for some 70 years before it achieved its fiscal union, counting from the end of the Civil War in 1865 to the Second New Deal in 1935-1936. The European Monetary Union was created in 1992 through the Maastricht Treaty, and the euro was introduced in 1999. At the age of 21, the euro is very much a youngster compared to the mighty dollar, and while fiscal union has scant support in Europe at this point in time, things might be very different in some 50 years' time, as they were for the US dollar.

CHART 13: US AND EURO ZONE EMPLOYMENT GROWTH, % YEAR-ON-YEAR



Source: FactSet, Indosuez Wealth Management.

The COVID-19 pandemic might accelerate change. Without adopting any direct mutualisation of the euro area's debt burden, every rule in the book has been relaxed in this crisis. Italy's plight is arguably driving the issue, as has that of Greece. As tardy and awkward Europe's response to Italy's dire COVID-19 situation was, it has to be said that it has reacted with breakneck speed compared to what happened after the 2008 crisis. Then it took 4 years and another crisis in 2011-2012 for Europe to "man up". Now it has set up new programmes in a matter of weeks and more are likely to follow in the coming months. The ECB has delivered open-ended commitments to expanding its support programmes as and when, the EU Council and European Commission continue to prepare additional measures, and with those back-stops, EU-member countries are in effect free to spend "whatever it takes" on measures that mitigate the effects of the pandemic. While no country's or region's response to the current crisis is likely to go down in history as having been perfect, Europe has clearly learned important lessons from the Global Financial Crisis.

Still, the fiscal impact will be severe. The euro area's general government budget which showed a deficit of 0.7% of GDP in 2019 will likely sink closer to -8% of GDP this year. Germany's budget surplus of 1.4% of GDP last year will be replaced by a deficit likely in excess of 5% of GDP. Italy, France, and Spain could all see deficits between 8-10% and while the former might sport the lowest deficit of the three, it still has the highest debt-to-GDP ratio which continues to perturb the European Union.

The UK's decision to leave the union has added to its woes, although the country never joined the euro. Many fear that Italy might one day opt for a similar decision. The next scheduled elections in Italy are due in May 2023 and presidential elections will be held in 2022. Change could come sooner, the country has after all had 68 different governments in 73 years, but no party is likely to seek to rock the boat in such a way in the midst of the global pandemic.

A poll conducted in March 2020 by the news agency ominously named Dire found that 67% of Italians consider EU membership to be a disadvantage, up from 47% in November 2018. Of course, evidence to the contrary can also be found. A Censis poll from late 2019 found only 25% of Italians in favour of leaving the Union. The rest of the union remains highly committed and we can see evidence of this in Germany's evolving stance towards region-wide funding solutions.

It is our profound conviction that the euro will survive with its current members intact, as was the case also in 2011-2012.

LATIN AMERICA

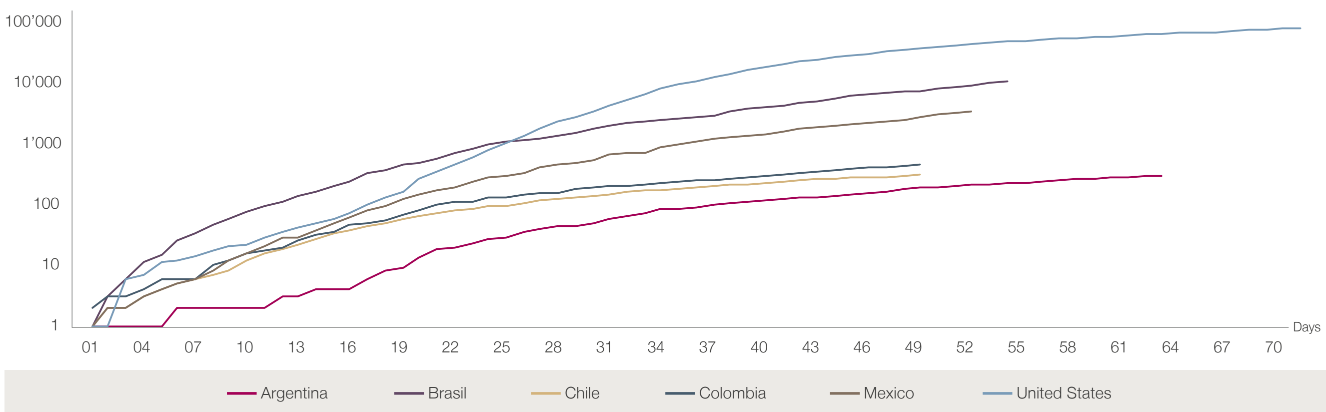
The COVID-19 pandemic arrived in the Latam region later (Chart 14) than in the rest of the world. So far, efforts to contain the virus have apparently been able to slow down the epidemic, but most countries have yet to reach the peak of new cases. In Latin America, many countries adopted social distancing measures earlier in comparison to Europe and the USA and, in all of the region, there are signs that the epidemic has slowed down. However, lack of resources, including tests and healthcare structures, has mad e the situation quite challenging across the region.

In Brazil, the scenario is particularly complex. The country is not only fast becoming one of the hotspots of the pandemic, but it is also facing a political crisis caused by President Bolsonaro's opposition to the epidemic control-measures introduced by local governments. The political crisis deepened with the resignation of his Minister of Justice, Sergio Moro, who left the government denouncing that the president was trying to interfere in the Federal Police. The growing political crisis prompted the president to start negotiations to form a larger coalition in congress, something that he had been refusing to do since the beginning of his administration. In part because of that, congress has so far ignored the political noise and has approved emergency legislation to fight the crisis, including support to local governments, the temporary lifting of fiscal rules, and providing additional tools for the central bank to expand liquidity in public and private bond markets through asset purchases. In all, fiscal measures announced so far amount to nearly 4.6% of GDP. Monetary policy is also on the move, with the central bank having already cut its policy rate from 4.5% to 3.25% since the beginning of the year and signalling that another cut of up to 75 basis points is likely at the next meeting.

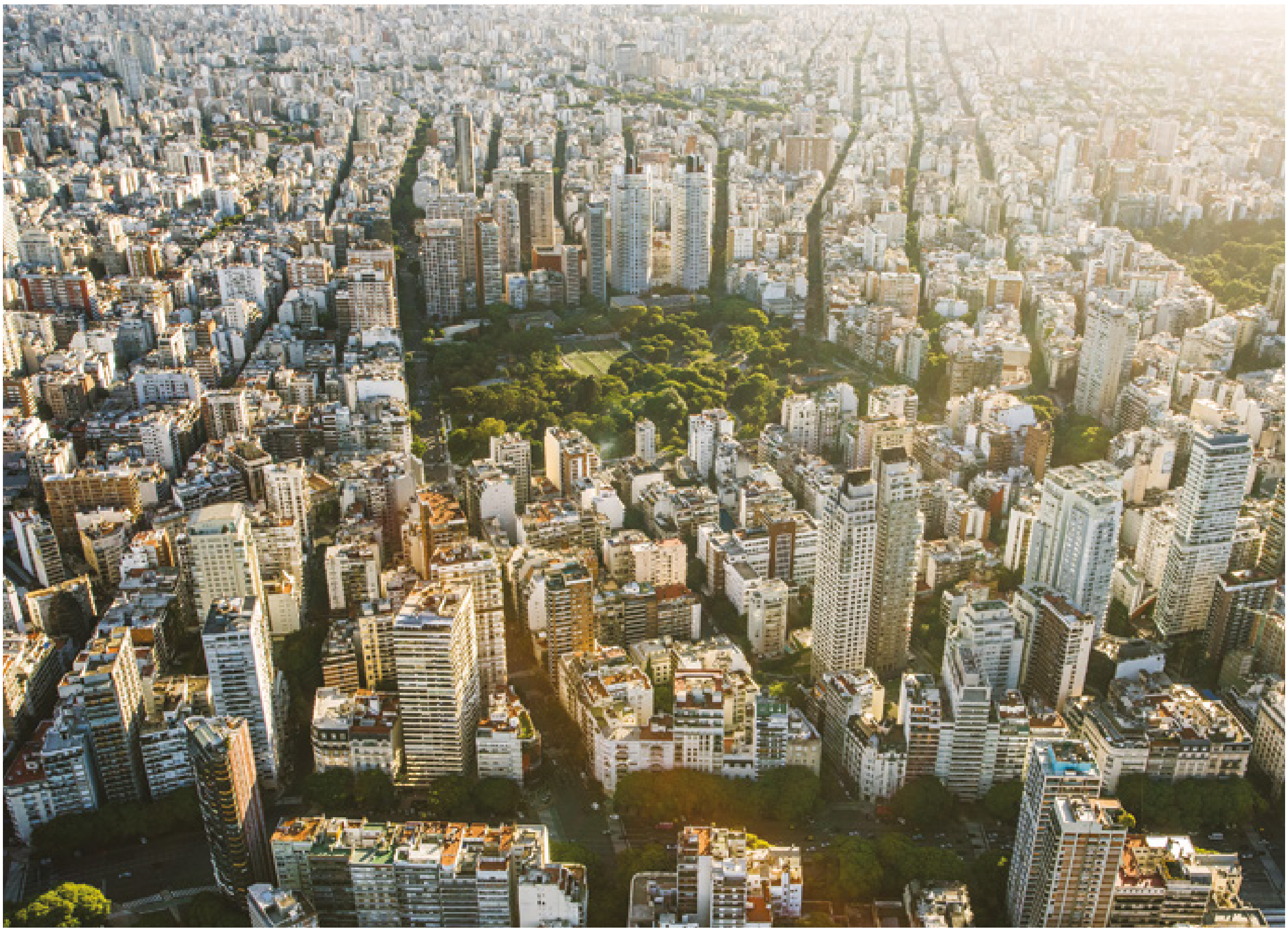
Inflation and expectations thereof have been trending down as demand collapses and the output gap widens. We expect this trend to continue in the short- and medium term, thus justifying the central bank's "dovish" posture. While the risks to inflation are limited in the short run and not a constraining factor, the sharp depreciation of the currency that occurred so far this year could pose some risks to financial stability. If that happens, monetary-policy easing could prove counterproductive. For now, we believe that those risks are limited by the low level of corporate leverage and exposure to exchange rate risks as well as by the good capitalisation of the banking system. However, the fiscal and monetary stimulus is not going to be enough to prevent a sharp recession. We expect GDP to fall by 4.7% in 2020 and to recover by 4.3% next year, with the risks to this scenario being clearly to the downside.

Mexico is also facing problems to contain the epidemic and its economy is likely to be severely hit by the pandemic crisis. Initial conditions were not good, with the economy already heading into a recession before the epidemic shock. The links to the US economy, the size of its tourism sector, and falling oil prices are likely to cause a deep recession this year. The economic policy reaction has been less strong than in most other countries in the region. The fiscal policy response has focused mostly on expanding the healthcare system and increasing social programmes. The fiscal outlook is made worse by the growing expectation that the government will have to increase its support for Pemex. As for the central bank, it has stepped up its response to the crisis since March, cutting its policy rate from 7% to 6% and announcing a series of measures to boost liquidity in the credit and foreign-exchange markets. We believe Mexico's economy will contract by at least 5% this year and will have a slow recovery, growing 3.8% in 2021.

CHART 14: CONFIRMED COVID-19 DEATHS



Source: JHU CSSE, Indosuez Wealth Management.



Buenos Aires, Argentina

Turning to Argentina, the country has been quite successful in "flattening the curve" by adopting very strict measures early on. However, the macro-economic situation, which was already dire, has taken a turn for the worse. The country is in default and negotiations with creditors are ongoing. With the sharp drop in growth and a weakening currency, the recovery rate on the debt is likely to be quite low. And, unlike what we expect for the rest of the region, inflation will continue to be a problem as the government relies more and more on monetisation to cover its expenses. While we still expect that once the debt-renegotiation process is over it will be possible to decrease the debt gradually, uncontrolled inflation in the medium term is a growing risk. We believe Argentina will be the most hardly hit country in terms of GDP growth, contracting by at least 6,1% in 2020 and rebounding by 3.4% in 2021.

The outlook for Chile and Colombia looks better. Both countries are doing relatively well in controlling their outbreaks. This should accelerate and facilitate the process of reopening the economies. In Chile, the fiscal position is much better than in the rest of the region, a fact that gives the government more leeway to increase expenditures in the short term without facing the same risks as all the other main countries in the region. Paradoxically, the health and economic crisis gave some relief for the government in the ongoing political crisis. The plebiscite regarding a new constitution has been postponed from April to October and President Pinera's approval ratings have improved. While the country will not avoid going into a sharp recession, we believe that it is going to be milder and less long-lasting than in most other countries, contracting by -3.5% this year.

For different reasons, Colombia is also likely to have better than average performance. The country is less dependent on the service sector, which will help to contain the damage to growth in the short and medium term. It also has higher potential growth and had more momentum before the crisis. It has some vulnerabilities such as a relatively weak fiscal position and some exposure to oil prices, but, overall, it should have a good performance in relative terms. We believe that the economy could shrink by -3% this year and is likely to be better positioned for a rebound in 2021.

MIDDLE EAST

Like the rest of the world, the Middle East is affected both by the COVID-19 pandemic and the (downward) movement in the oil price. The trend of both these factors is difficult to predict.

However, the density of the population and percentage of the urban population can help us to gauge the severity of the pandemic on a regional level. The greater the concentration of the population, the higher the probability of a severe epidemic. The United Arab Emirates (UAE) have a population density of just 136 people per square kilometre (km^2) of land. This said, the majority of the population - 87% - lives in the cities. Thus, the high proportion of the population that lives in urban areas means that the virus can spread more easily and more rapidly, which should more than offset the low population density. Similar conclusions apply to Saudi Arabia.

Most countries in the region have imposed quarantine measures, as well as partial or stricter lockdowns. For example, Kuwait has suspended work in the public sector until 31 May and imposed a curfew between 4:00 pm and 8:00 am. Saudi Arabia has imposed a partial lockdown in the main cities and governorates. Residents can only leave their homes for essential needs between 6:00 am and 3:00 pm and must remain in their residential area. The country has also signed a deal with China, which will provide 9 million testing kits, 500 technicians and 6 laboratories.

The young age of the population could prove to be an advantage in its resistance to the crisis. Conversely, before the pandemic this population group was already struggling to access the labour market (the unemployment rate for young people is around double that of the general population). More generally, the endemic unemployment problem will be exacerbated by the spread of the disease.

How resilient is the healthcare system? With 2.4 doctors per thousand inhabitants, the United Arab Emirates is ranked at the same level as countries such as Poland or South Korea. This ratio is 1.3 for the MENA (Middle-East and North Africa) countries, 1.1 for the Arab world and 1.5 for the whole world. With regard to available hospital beds, the ratio for the UAE is 1.2 for each thousand inhabitants, which is below the average of 1.6 for MENA and the world average of 2.7. These two indicators show us that the region's capacity to face an epidemic crisis is limited, especially in terms of hospital space.

It is hard to find data relating to the development of the pandemic in the region. We will likely have to wait some time before we are able to obtain reliable numbers that could confirm our analysis. In the meantime, Table 4 provides an indication of the number of people affected at the end of April, in absolute numbers and as a percentage of the population.

It is obviously too early to assess the economic cost of the pandemic to the extent that we do not have any point of comparison. The recession underway in the mature economies reminds us of the 2008-2009 financial crisis, while the drop in the oil price is similar to the oil shock in 2015. It is probable that the abrupt setback experienced by the countries in the region will be greater than on these two occasions. If it is equal to a drop in real GDP of 3.1% in 2020 (IMF forecast), the region will fall within the average of the global slowdown, which we expect at 3%. The shock is likely to be already felt in the Q1 figures, notably in Saudi Arabia, where nominal GDP growth could fall by 12% QoQ. A particularly negative consequence of the pandemic is that the economic diversification efforts over the past few years will be penalised. The service sector (notably tourism, hotels, air travel), which has served as an alternative source of growth to the industry, is highly impacted.

TABLE 4: COVID-19 MIDDLE EAST AND NORTH AFRICA STATISTICS, APRIL 2020

Region	Case count	% of population	Recoveries
Global	3'245'901	0.04	988'540
Iran	94'640	0.11	75'103
Saudi Arabia	21'402	0.06	2'953
Qatar	12'564	0.44	-
UAE	12'481	0.13	2'429
Egypt	5'268	0.01	1'335
Morocco	4'359	0.01	969

Region	Case count	% of population	Recoveries
Kuwait	4'024	0.09	1'539
Algeria	3'848	0.01	1'702
Bahrain	2'921	0.17	1'455
Oman	2'348	0.05	-
Iraq	2'003	0.00	1'346
Tunisia	980	0.01	-
Lebanon	725	0.01	-

Source: Bloomberg, Indosuez Wealth Management.

Dubai, United Arab Emirates

The drop in the oil price does not call into question the economic viability of production in Saudi Arabia, Iran or Iraq. The cost of production per barrel is around 8, 9 and 10.5 dollars respectively in these countries. However, the combination of the drop in prices and in volumes erodes their public finances at a time that they are greatly needed to fund the support measures implemented to fight the effects of the pandemic.

The size of the fiscal package represents significantly less than what is planned in the mature economies. However, the debt-to-GDP ratio will increase, especially as an acceleration in inflation is unlikely, at least in the short term. In particular, some countries are facing deflation, with a year-on-year change in consumer prices of -1.3% in the UAE, -1,8% in Dubai, and -1.4% in Qatar.

More specifically, in Saudi Arabia, a package of measures destined to support the private sector totalling 18.7 billion dollars was announced. In addition, use of the unemployment insurance fund will increase spending by 0.4% of GDP. This will be offset by a reduction in certain government budget items. Nonetheless, the net balance corresponds to a fiscal stimulus, probably below 3% of GDP. In the UAE, authorities decided on fiscal measures totalling 7.2 billion dollars, i.e. 2% of GDP.

In this context the central banks have followed the same path as their peers in the developed world by providing large amounts of liquidity to the economy. Given that many of the region's currencies are pegged to the US dollar (the Saudi riyal, Qatari riyal, Bahraini dinar, Omani riyal and UAE dirham), the interest rate cut made by the US Federal Reserve enabled the issuing authorities of the region to lower their rates in turn: from 4% to 2.25% in Bahrain, from 2.1% to 0.5% in Oman, from 2% to 1% in Qatar, from 2.25% to 1% in Saudi Arabia and from 2% to 0.75% in the UAE.

Like the other central banks, the Saudi issuing authority has set up a financing facility, equal to 2% of GDP, to enable commercial banks to support the private sector, in particular SMEs. The central bank of the UAE has taken diverse measures totalling 20% of GDP to encourage lending to the private sector.

To conclude, note that a de-anchoring from the dollar is not on the agenda in the region and is not part of the planned policy mix. In particular, the Saudi central bank has highlighted that currency reserves cover 43 months of imports and 88% of money supply in its broadest definition (M3).

New York, United States

IMPLICATIONS FOR ASSET CLASSES

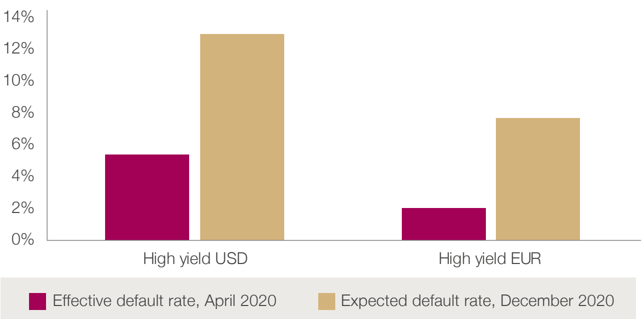
Before addressing the question of the current impact of the policy mix on the markets, we must determine what we include in our definition of policy mix. The depth of the recession expected this year is the result of the decision by most governments to place their population under lockdown, thereby bringing economic activity to a virtual standstill. We consider that the lockdown measures are public health measures and do not fall under the budget/government component of the policy mix, and we are mainly focusing here on the fiscal and monetary measures taken to combat the recession caused by these lockdowns.

BOND MARKETS

Bonds are the asset class (Chart 15) most directly impacted by the current policy mix that we will summarise with its pillars and main consequences: an expansionist budgetary policy that raises the question of its sustainability, and implying a structurally accommodative monetary policy that aims to ensure both the financing of the economy and public debt.

Regarding sovereign bonds, the core issue resides in investors' confidence in the signal sent out by the central banks and the lasting nature of this support: if the markets are convinced that the central banks will never exit their quantitative easing and will continue to carry out the job of refinancing the governments and providing reassurance on the peripheral risk, we can exclude the scenario of a repetition of the sovereign crisis of 2011-2012, and adopt the baseline assumption that the slope of the yield curve of the OECD countries and the peripheral spreads in the Euro Zone will be contained by the ECB even in the event of a downgrade in sovereign credit ratings by the rating agencies.

CHART 15: DEFAULT RATE, HIGH YIELD DEBT, %



Source: Moody's, Indosuez Wealth Management.

If discord becomes apparent and sparks doubts with regard to this outlook, we could fear a renationalisation of the sovereign risk in the Euro Zone, and a steepening of the yield curve to reflect a deterioration in the debt-to-GDP ratios. A nuance is probably required in the case of emerging sovereign debt, notably in Latin America, which is exposed to both the global macro-economic shock and the fall in the oil price, and remains dependent on the flow of international capital.

In the corporate bond market, the correction in March reflected a sharp deterioration in fundamentals as well as a liquidity shortage. This recession, like the previous ones, will clearly come hand in hand with downgrades by the rating agencies and a rise in default rates in the high yield segment, which will be sharper in the hardest-hit industrial sectors such as energy, automobile, air transport, specialised retail and commercial real estate. However, the current policy mix - consisting on the fiscal front of plans to lower or defer taxation and subsidise part-time unemployment, and on the monetary front of increasing and widening the scope of the asset purchases to corporate bonds - is a powerful support factor. Furthermore, the many aid mechanisms for refinancing companies set up jointly by the governments and central banks are intended to limit the rise in company bankruptcies. Everything will ultimately depend on the length of the lockdowns and strength of the recovery to contain the rise in default rates.

The compression of credit premiums started at the end of March and then reacted very quickly to the announcements by the Federal Reserve at the beginning of April. Credit markets often hit bottom ahead of the macro-economic trough, and it was the double combination of the central banks' signal and improvement in liquidity that enabled corporate bonds to start to rebound.

Lastly, note that the stance of the governments and European regulators concerning the dividends of companies in the financial sector are a positive catalyst for holders of subordinated bonds, providing greater security for their coupons, on the condition, however, that the sector does not become loss-making due to the provisioning policies.

Stellenbosch, South Africa

EQUITY MARKETS

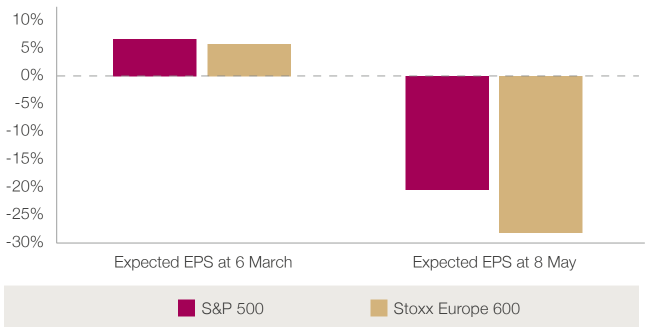
Equity analysts generally expect that a one-point drop in economic growth (Chart 16) theoretically leads to a decline in earnings of approximately 10%; mathematically this would imply a 50% reduction in earnings, but this probably does not factor in all of the effects of the powerful support of the policy mix currently being implemented.

With regard to equity markets, there are two sides to the question that arises from the fiscal policy:

- In the short term, the exceptional support measures implemented by the governments could mitigate the impact of the recession both in terms of earnings (assistance for part-time working, for example) and *vis-à-vis* the default risk (the refinancing and guarantee schemes), but cannot fully offset it, as seen in the Q1 results, which are set to be down by 20% to 25% on average while the lockdown did not come into effect until March;
- In the medium term, if the economic policy succeeds in orchestrating a rapid recovery in activity once lockdown orders are lifted, investors will anticipate a rapid rebound in profits in 2021 and will be much less concerned about the extent of the drop in earnings in 2020.

Furthermore, the impact of the monetary policies on the equity markets must be considered. Firstly, the refinancing schemes for businesses and banks represent significant support, as mentioned in the case of bonds. Secondly, all things being equal, the zero to negative rates have the automatic effect of increasing the valuation-multiples of equities, by lowering the discount rate of future earnings. This is thus favourable for the majority of the market, and in particular for companies with visibility on growth. Conversely, these interest rate policies generally prove to be penalising for the financial sector; the ECB had, however, set up a "tiering" mechanism in order to reduce the cost of banks' reserves, and had significantly lowered the cost of refinancing through the TLTRO (Targeted longer-term refinancing operations) programme (which is favourable for interest margins), while the central banks decided to temporarily alleviate the capital

CHART 16: EARNINGS GROWTH CONSENSUS EXPECTATIONS, 2020, %



Source: FactSet, Indosuez Wealth Management.

requirements for banks to prevent regulation from being pro-cyclical. But once again, this will only partially allay the effects, and bank stocks are among the hardest hit at the earnings level, due to the rise in the cost of risk on the financing activity.

The third question concerns the measures to suspend dividends. The measures taken by some governments regarding the dividends of financial sector companies or companies benefiting from state aid for partial unemployment have negatively impacted European equity markets compared to the US equity markets. In theory, the fact that dividends are not paid does not change the equity value for the shareholder and is more a question of cash flow and the company's use of the undistributed amounts. But the importance of the dividend theme in the investment logic for many stocks in the European market and in the strategy of many equity managers explains the particularly negative reaction of the market in the sectors concerned, which in addition are generally cyclical stocks. More broadly, the end of the lockdowns will probably not mark a return to normal, and the political and media pressure on dividend pay-outs and share-buyback policies logically risk remaining strong.

Ultimately, this crisis and the resulting policy mix is likely to contribute to increasing the structural polarisation of the equity markets between quality stocks and cyclical stocks, between innovation stocks and those which are intensive in human capital and physical investment, and between consumer goods and capital goods.

FOREIGN EXCHANGE MARKETS

Such a change in policy mix is not without impact on the value of currencies with respect to one another. Before the start of the COVID-19 outbreak, the majority of economists were expecting the dollar to drop against the euro, notably on the basis of the rate cuts in 2019 and the deceleration in US growth, leading them to anticipate a re-rating of the euro against the greenback. The Federal Reserve's spectacular decision to lower short-term rates to zero (the lower bound of the federal funds rate) and significantly increase the size of its balance sheet initially signalled a catalyst that would allow this anticipation to materialise, like in H2 2008. The rate differential between the United States and the Euro Zone has indeed never been so small since 2005.

However, in this context of strong risk aversion and search for liquidity, the dollar has remained strong. This is compounded by the fact that the uncertainty hovering over the budget solidarity in the Euro Zone and the European Central Bank's ability to be more active are set to continue to weigh on the euro. Moreover, the accommodative monetary response of emerging countries and the two-fold risk that is arising (political risk and rating risk) weakens the emerging currencies, some of which are also affected by the collapse in the oil price in 2020. The dollar both plays the role of safe haven in this unprecedented situation, and benefits from its status as the world's reference currency, while the inverse correlation between the oil price and the dollar favours the US currency.

Over the long term, we can expect that several fundamental factors (interest rate differential, current account, purchasing power parity) will strengthen the euro, on the condition of reduced political uncertainty. We can also expect, over the long term, that China will gradually succeed in making its currency a reference reserve currency that could potentially serve to anchor other Asian currencies. But in the short term, in a context in which all central banks have cut their rates and increased the size of their balance sheets, the price of gold is set to remain high against all of these currencies, especially with the decrease in the opportunity cost of holding it in a world of zero or negative rates in the United States, Europe and Japan.

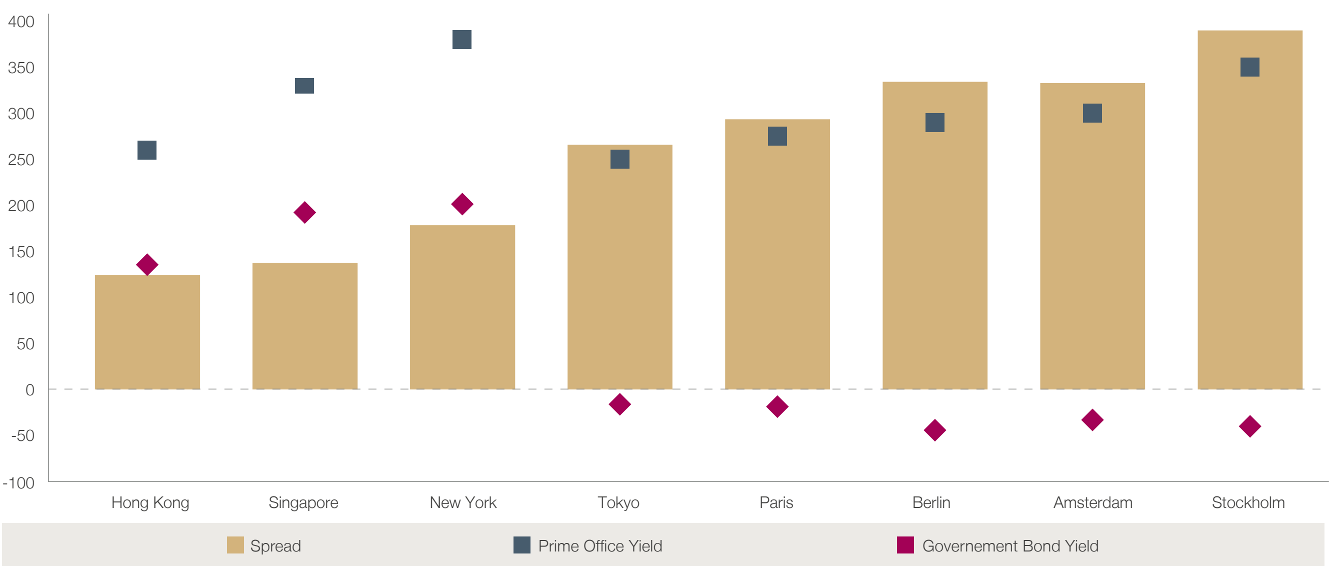
REAL ESTATE

Real estate remains the main asset class for many private investors, and as it generally constitutes a marker of recession as well as being on the receiving end of numerous fiscal support measures, it is crucial to address the stakes created by the current policy mix in this investment area. The current crisis has a specific impact on the real estate sector; in the short term, the lockdowns hamper activity and therefore affect the value of commercial property, for which the rents are indexed to sales (Chart 17). In the longer term, we can anticipate that this crisis will have the effect of accelerating the shift to e-commerce while encouraging companies to adopt remote working practices, which could potentially reduce demand for office space and thereby also reduce the upwards pressure on prices after a decade of strong growth. However, the monetary policy of structurally low interest rates is set to lead a large number of institutional and private investors to transfer to real estate the role that was attributed to government bonds, i.e. generating returns with limited risk, but with much less liquidity than these bonds.

Regarding households, the persisting low interest rates continue to ensure demand. The monetary policies should continue to represent strong support for the residential and business real estate market in Europe. Residential real estate also remains protected by its status as a safe haven and a wealth asset. Lastly, the lifting of the lockdowns could see the resumption of transactions that were delayed between March and May.

Nevertheless, the main risk in Europe lies in the rise in unemployment after a decade that has seen prices increase sharply and households' mortgage debt continue to grow. The banks should continue to lend to households in Europe. In the United States, we could however fear that the recent surge in unemployment (a cumulative 30 million jobless claims over six weeks) could lead to a rise in the default rate in the residential real estate segment with the consequence of an adjustment in the value of mortgage-backed securities, but which here again benefit from the Fed's capacity to purchase this asset class on its balance sheet. We also note that US households have lower debt than in 2008. In any case, beyond possible measures targeting the sector, the factors of time (lockdown and recovery) and confidence will impact the trajectory of the market.

CHART 17: PRIME OFFICE YIELD SPREAD OVER 10 YEAR GOVERNEMENT BONDS, BASIS POINTS



Source: JLL Q2 2019, PMA, Bloomberg, Oct 2019, Indosuez Wealth Management.

PRIVATE EQUITY

In general, private equity is likely to be subject to the same fundamental impacts identified on the equity markets. More specifically, we can imagine that institutional demand for the asset class will remain strong in the low interest-rate environment, and that private investors will continue to show interest in an asset class where the lack of a market listing somewhat erroneously can be perceived as reduced portfolio risk, which is too often reduced to the measure of volatility, whereas we know that the shareholding structure of a company (held by a fund or listed on the market) does not have an impact on its intrinsic risk (Chart 18).

In more fundamental terms, the challenges arising from the current crisis and its potential structural effects on entire sections of activity could lead investors to prefer to invest in a more concentrated portfolio of companies that are actively followed by an active reference shareholder.

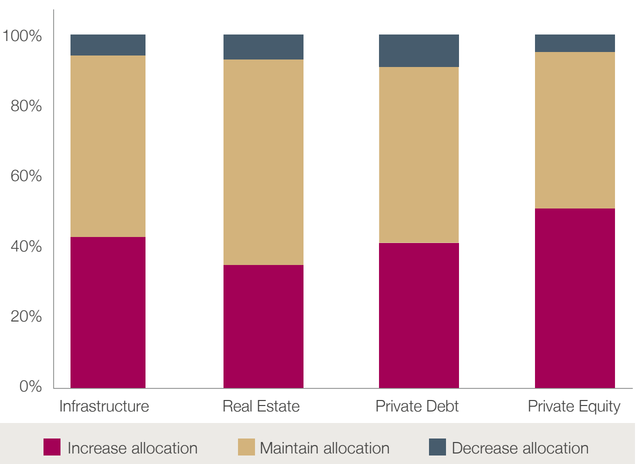
Lastly, we do not anticipate that the crisis and the resulting policy mix will structurally weaken the capacity to refinance operations, despite the anticipated increase in the number of defaults in the leveraged loans segment, notably in the US.

LIFE INSURANCE

Since life insurance is a key asset class in several European countries (Chart 19) and notably in France, it is difficult not to address this question. We will nevertheless abstain from speculating on the possible changes in the regulatory component of the policy mix, to focus more specifically on the direct effects expected from the fiscal and monetary aspects.

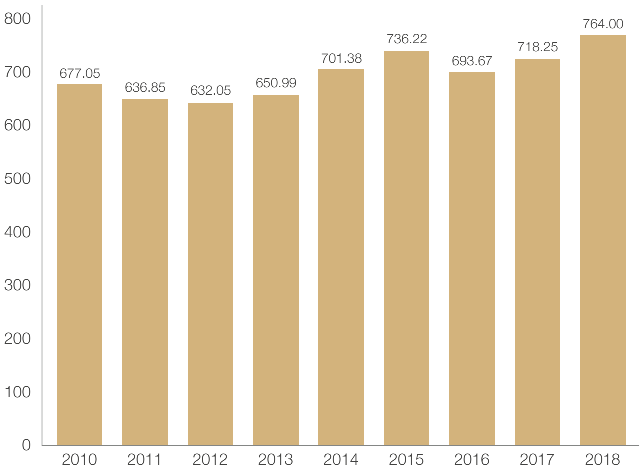
The negative interest rate policy in the Euro Zone will continue to restrict the investment policy of insurers by leading them to seek returns on corporate bonds or real estate, which is made sustainable by the very long maturity of insurers' liabilities; in this respect, the increase in the risk premium on corporate bonds observed in March probably represented an investment opportunity for insurers. We also see major differences in investment policy on insurers' balance sheets, with a lower weight of illiquid assets and equities at continental European insurers compared to their UK peers. But on a trend basis, we believe that there is a greater likelihood of an erosion of the returns on euro funds than the contrary. Conversely, to the extent that we do not forecast a rapid steepening of the yield curve due to the actions taken by central banks, we do not anticipate a major risk for the sector. In the short term, the context of uncertainty and volatility is set to continue to drive inflows this year.

CHART 18: INVESTORS' INTENDED EVOLUTION IN LONG-TERM ASSET ALLOCATION, % TOTAL



Source: Prequin, Indosuez Wealth Management.

CHART 19: LIFE INSURANCE EACH YEAR IN EUROPE, EUR BILLION



Source: Statista, Indosuez Wealth Management.

Chicago, United States

PERFORMANCE TABLES

TABLE 5: ANNUAL COMMODITY PERFORMANCE, LOCAL CURRENCY, %

COMMODITIES	2016	2017	2018	2019	01.01 to 11.06.2020
Steel Rebar (CNY/Mt)	60.46%	42.69%	-8.19%	-1.91%	-5.16%
Gold (USD/Oz)	8.14%	13.53%	-1.56%	18.31%	13.87%
Crude Oil WTI (USD/Bbl)	45.03%	12.47%	-24.84%	34.46%	-40.48%
Silver (USD/Oz)	15.84%	7.23%	-9.36%	15.32%	-0.18%
Copper (USD/Mt)	17.65%	30.92%	-17.69%	3.50%	-6.63%
Natural Gas (USD/MMBtu)	59.35%	-20.70%	-0.44%	-25.54%	-17.18%

TABLE 6: ANNUAL FIXED INCOME PERFORMANCE, LOCAL CURRENCY, %

CORPORATE BONDS	2016	2017	2018	2019	01.01 to 11.06.2020
Governments Bonds Emerging Markets	6.29%	12.49%	-10.62%	1.88%	-7.29%
US Government Bonds	1.11%	1.10%	1.41%	5.22%	5.72%
Euro Government Bonds	1.86%	0.39%	0.40%	3.16%	0.21%
Corporate EUR High yield	8.14%	4.82%	-3.37%	9.55%	-5.69%
Corporate USD High yield	15.31%	6.32%	-1.48%	14.65%	-4.40%
Corporate Emerging Markets	7.61%	2.84%	-6.89%	9.11%	-3.11%

TABLE 7: ANNUAL FOREIGN EXCHANGE RATES PERFORMANCE, SPOT, %

CURRENCIES	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	01.01 to 11.06.2020
EUR/CHF	-15.70%	-2.71%	-0.74%	1.63%	-1.99%	-9.54%	-1.48%	9.16%	-3.82%	-3.55%	-1.73%
GBP/USD	-3.45%	-0.44%	4.58%	1.86%	-5.92%	-5.40%	-16.26%	9.51%	-5.62%	3.94%	-4.94%
USD/CHF	-9.66%	0.31%	-2.42%	-2.46%	11.36%	0.78%	1.69%	-4.39%	0.80%	-1.58%	-2.32%
EUR/USD	-6.54%	-3.16%	1.79%	4.17%	-11.97%	-10.22%	-3.18%	14.15%	-4.48%	-2.22%	0.77%
USD/JPY	-12.80%	-5.19%	12.79%	21.39%	13.74%	0.37%	-2.71%	-3.65%	-2.66%	-0.98%	-1.60%

TABLE 8: ANNUAL EQUITY INDEX PERFORMANCE, PRICE INDEX, LOCAL CURRENCY, %

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	01.01 to 11.06.2020
20.89%	0.00%	19.42%	51.46%	51.66%	9.93%	27.92%	38.71%	-6.24%	36.07%	-2.46%
16.99%	-5.55%	18.01%	29.60%	11.39%	6.79%	16.44%	34.35%	-9.27%	28.88%	-6.63%
16.36%	-7.62%	17.71%	24.09%	8.08%	5.58%	14.43%	21.78%	-10.44%	25.19%	-7.08%
12.78%	-11.34%	15.15%	17.37%	4.35%	-0.73%	9.54%	20.96%	-12.48%	23.16%	-7.69%
12.07%	-18.94%	14.37%	14.43%	2.92%	-2.74%	8.57%	20.83%	-13.24%	15.42%	-8.65%
9.55%	-19.16%	13.40%	0.61%	2.23%	-4.93%	5.32%	20.11%	-16.31%	15.37%	-10.86%
9.00%	-20.41%	13.18%	-5.03%	-2.71%	-11.31%	2.87%	19.69%	-16.57%	15.21%	-15.09%
8.63%	-21.92%	7.55%	-7.65%	-4.62%	-16.96%	-1.20%	19.42%	-17.80%	13.71%	-19.43%
-0.97%	-22.57%	5.84%	-8.05%	-14.78%	-22.37%	-1.85%	7.68%	-18.71%	12.10%	-21.27%
-12.51%	-25.01%	5.43%	-15.72%	-17.55%	-32.92%	-11.28%	7.63%	-25.31%	11.20%	-31.63%

BEST PERFORMING

WORST PERFORMING

FTSE 100 | Topix | MSCI World | MSCI EMEA | MSCI Emerging Markets
Stoxx Europe 600 | S&P 500 | Shanghai SE Composite | MSCI Latam | MSCI Asia Ex Japan

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

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Dr Paul Wetterwald
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The banks of the Indosuez Wealth Management Group are preparing for the replacement or restructuring of interbank interest rates, such as the LIBOR, EURIBOR and EONIA, the fixing terms of which will be strengthened significantly, as decided by the financial market authorities and banking agents. At the European level, the European Central Bank began publishing the €STR (Euro Short Term Rate) in October 2019, which will sit alongside the EONIA until December 2021 and will replace it in January 2022. Concerning the EURIBOR, the European Money Markets Institute confirmed in November 2019 that the transition phase for the Hybrid EURIBOR has been completed, paving the way for full restructuring between now and December 2021. Each IBOR interest rate (e.g. the LIBOR US Dollar) will also be overhauled between now and the end of 2021. Accordingly, the Swiss National Bank announced in June 2019 the introduction of its own policy interest rate in Swiss francs, calculated based on the SARON (Swiss Average Rate Overnight) with the goal of creating forward rates that will also be calculated based on the SARON.
The Indosuez Wealth Management Group is following all of these reforms very closely and has a specific framework to cover all related legal, commercial, and operational impacts. For now, you are not required to do anything in relation to your financing operations or investments indexed to the benchmark rates concerned by these changes. You will receive further information once a better picture surrounding the details of the replacements are known. Please feel free to contact your account manager if you have any questions.

GLOBAL PRESENCE

OUR STORY

For more than 140 years we have advised entrepreneurs and families around the globe, supporting them with expert financial advice and exceptional personal service.

To this day we serve each and every client as an individual, helping them build, protect and pass on their wealth.

Truly personal service resonates with our clients and, when combined with the financial strength and complimentary expertise of Crédit Agricole Group, one of Europe's top 10 banks, it results in a unique approach to building value for entrepreneurs and families around the world.

INDOSUEZ WEALTH MANAGEMENT

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GLOSSARY

Backwardation: Refers to a situation where a futures contract's price is below the spot price of the underlying. The opposite situation is referred to as Contango.

Barbell: An investment strategy that exploits two opposing ends of a spectrum, such as going long both the short- and long-end of a bond market.

Basis point (bps): 1 basis point = 0.01%.

Below par bond: A bond trading at a price inferior to the bond's face value, i.e. below 100.

Bottom-up: Analyses, or investment strategies, which focus on individual corporate accounts and specifics, as opposed to top-down analysis which focuses on macro-economic aggregates.

Brent: A type of sweet crude oil, often used as a benchmark for the price of crude oil in Europe.

Bund: German sovereign 10-year bond.

Call: Refers to a call option on a financial instrument, i.e. the right to buy at a given price.

CFTC (Commodity Futures Trading Commission): An independent US federal agency with regulatory oversight over the US commodity futures and options markets.

COMEX (Commodity Exchange): COMEX merged with NYMEX in the US in 1994 and became the division responsible for futures and options trading in metals.

Contango: Refers to a situation where the price of a futures contract is higher than the spot price of the underlying asset. The opposite situation is referred to as Backwardation.

CPI (Consumer Price Index): The CPI estimates the general price level faced by a typical household based on an average consumption basket of goods and services. The CPI tends to be the most commonly used measure of price inflation.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates, expressed in years. The longer the duration of a bond, the more its price is sensitive to any changes in interest rates.

EBIT (Earnings Before Interest and Taxes): Refers to earnings generated before any financial interest and taxes are taken into account. It takes earnings and subtracts operating expenses and thus also corresponds to "operating earnings".

EBITDA (Earnings Before Interests, Taxes, Depreciation and Amortisation): EBITDA takes net income and adds interest, taxes, depreciation and amortisation expenses back to it. It is used to measure a company's operating profitability before non-operating expenses and non-cash charges.

ECB: The European Central Bank, which governs the euro and euro-member countries' monetary policy.

Economic Surprises Index: Measures the degree of variation in macro-economic data published versus forecasters' expectations.

EPS: Earnings per Share.

ESG: Environmental, Social and Governance.

ESMA: European Securities and Markets Authority.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

Futures: Exchange-traded financial instruments allowing to trade the future price of an underlying asset.

G10 (Group of Ten): One of five groups, including also the Groups of 7, 8, 20 and 24, which seek to promote debate and cooperation among countries with similar (economic) interests. G10 members are: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the UK and the US with Switzerland being the 11th member.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

GHG: Greenhouse gases.

Gulf Cooperation Council (GCC): A grouping designed to favour regional cooperation between Oman, Saudi Arabia, Kuwait, Bahrain, United Arab Emirates and Qatar.

High yield: A category of bonds, also called "junk" which ratings are lower than "investment grade" rated bonds (hence all ratings below BBB- in Standard & Poor's parlance). The lower the rating, the higher the yield, normally, as repayment risk is higher.

Hybrid securities: Securities that combine both bond (payment of a coupon) and share (no or very long maturity date) characteristics. A coupon might not be paid, as with a dividend.

iBoxx investment grade/high yield indices: Benchmarks measuring the yield of investment grade/high yield corporate bonds, based on multi-source and real-time prices.

IMF: The International Monetary Fund.

Investment Grade: A "high quality" bond category rated between AAA and BBB- according to rating agency Standard & Poor's.

LIBOR (London Interbank Offered Rate): The average interbank interest rate at which a selection of banks agree to lend on the London financial market. LIBOR will cease to exist in 2020.

LME (London Metal Exchange): The UK exchange for commodities such as copper, lead, and zinc.

Loonie: A popular name for the Canadian dollar which comes from the word "loon", the bird represented on the Canadian one dollar coin.

LVT: Loan-to-Value ratio; a ratio that expresses the size of a loan with respect to the asset purchased. This ratio is commonly used regarding mortgages, and financial regulators often cap this ratio in order to protect both lenders and borrowers against sudden and sharp drops in house prices.

Mark-to-market: Assessing assets at the prevailing market price.

OECD: Organisation for Economic Co-operation and Development.

OPEC: Organisation of Petroleum Exporting Countries; 14 members.

OPEC+: OPEC plus 10 additional countries, notably Russia, Mexico, and Kazakhstan.

Policy-mix: The economic strategy adopted by a state depending on the economic environment and its objectives, mainly consisting of a combination of monetary and fiscal policy.

PMI: Purchasing Managers' Index.

Put: An options contract that gives the owner the right, but not the obligation, to sell a certain amount of the underlying asset at a set price within a specific time period. The buyer of a put option believes that the underlying stock price will fall below the option price before expiration date. The value of a put option increases as that of the underlying asset falls, and vice versa.

Quantitative Easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

Renminbi: Translating literally from Chinese as "currency of the people", this is the official name of China's currency (except in Hong Kong and Macao). It is also frequently referred to as the yuan.

Russell 2000 Index: A benchmark measuring the performance of the US small cap segment. It includes the 2000 smallest companies in the Russell 3000 Index.

SEC (Securities and Exchange Commission): The SEC is an independent federal agency with responsibility for the orderly functioning of US securities markets.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

SRI: Sustainable and Responsible Investments.

Subordinated debt: Debt is said to be subordinated when its repayment is conditional upon unsubordinated debt being repaid first. In return for the additional risk accepted, subordinated debt tends to provide higher yields.

Swap: A swap is a financial instrument, often over the counter, that enables two financial flows to be exchanged. The main underlyings used to define swaps are interest rates, currencies, equities, credit risk and commodities. For example, it enables an amount depending on a variable rate to be exchanged against a fixed rate on a set date. Swaps may be used to take speculative positions or hedge against financial risks.

USMCA: The United States-Mexico-Canada Agreement, signed by the political leaders of the three countries on 30 September, 2018, replacing NAFTA (created in 1994).

VIX: The index of implied volatility in the S&P 500 Index. It measures market operators' expectations of 30-day volatility, based on index options.

Wedge: A wedge occurs in trading technical analysis when trend lines drawn above and below a price chart converge into a arrow shape.

WTI (West Texas Intermediate): Along with Brent crude, the WTI is a benchmark for crude oil prices. WTI crude is produced in America and is a blend of several sweet crude oils.

WTO: The World Trade Organisation.

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