Schroders

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Economic and Strategy Viewpoint

June 2020

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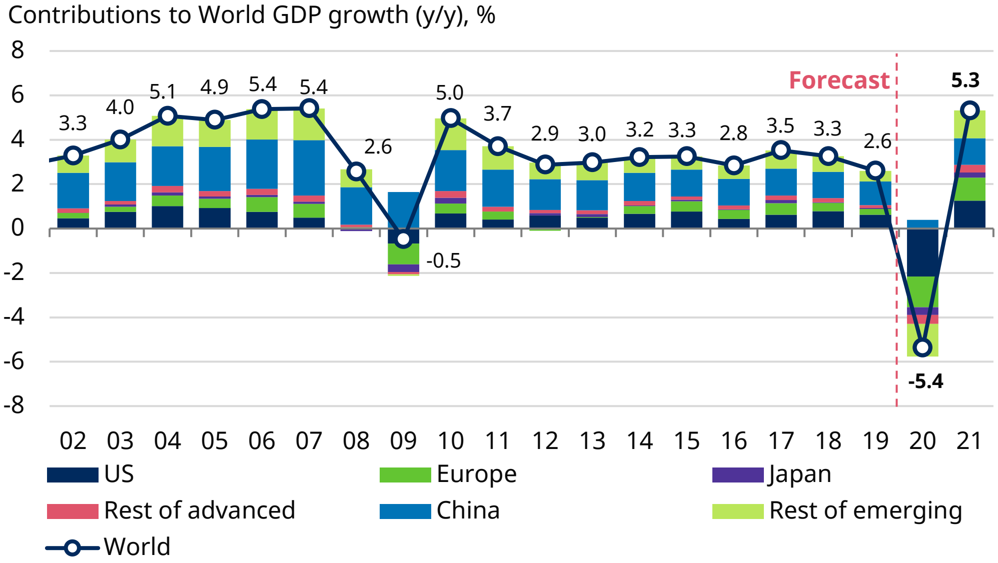
Forecast update: More U than V

- We are downgrading our forecast for global growth once more to reflect the weakness of the first quarter. Activity remains weak, but there are signs we are past the worst and a bounce back in activity is expected in Q3.
- However, beyond this point uncertainty abounds. Forecasting the economy has become a judgement on the speed with which lockdowns are lifted around the world and the subsequent path of the virus. Our central view is that the virus is contained, but epidemiologists stress the risks of a second wave of infection.
- Meanwhile, governments need to rein in fiscal support and after pent-up demand has been satisfied the pandemic is likely to make households more cautious. Business is also expected to be hesitant in resuming capital spending and like government will look to reduce their debt levels.
- The recovery is tempered as a result and such scarring effects mean we do not regain pre-Covid levels of activity by the end of 2021, making the forecast less of a V shape and more of a U.

Chart: 2020 will be worst year since 1930's for world economy



Source: Schroders Economics Group, 28 May 2020.

Forecast update: More U than V

"Crossing the river by feeling the stones".

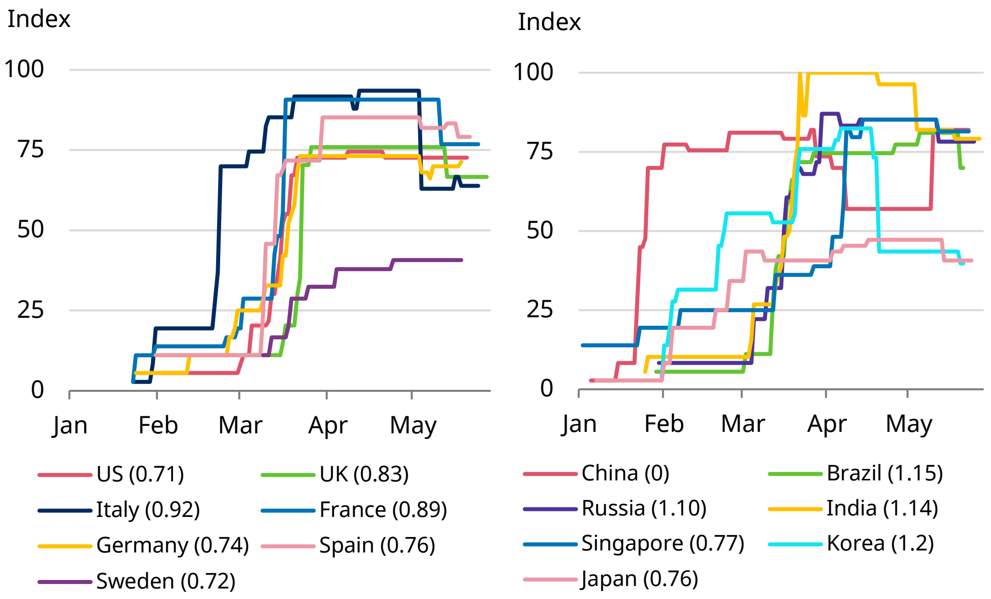
Deng Xiaoping.

Outlook driven by lifting of lockdowns and path of virus...

Forecasting the economy has become a judgement on the speed with which lockdowns are lifted around the world. The faster restrictions can be eased and businesses are allowed to re-open, the faster the recovery in economic activity. Slow easing will bring slow recovery and, even worse, risk creating permanent damage as the near-term effects becomes more difficult to reverse.

One response might be to hand the economic forecast over to a team of epidemiologists who can make the best estimates of how the virus is likely to progress and the order in which lockdowns can be eased around the world. In this respect, the reproduction or R rate (the number of people each infected person infects) has become the key variable with a value below one being seen as a necessary condition for allowing a return toward normality. A number of economies have achieved this and as a result, are beginning to gradually ease lockdown measures. This is evident from the Oxford University tracking of the lockdown stringency (chart 1).

Chart 1 and 2: Tracking lockdown stringency



Source: Hale, Thomas, Sam Webster, Anna Petherick, Toby Phillips, and Beatriz Kira (2020). Oxford COVID-19 Government Response Tracker, Blavatnik School of Government, Schroders Data Insights, Schroders Economics Group. 27 May 2020.
R estimates (in parenthesis) are 5-day moving average as of 22 May, calculated using Imperial College London 'EpiEstem' R package using number of deaths, except for Singapore which uses cases.

...which remain very uncertain

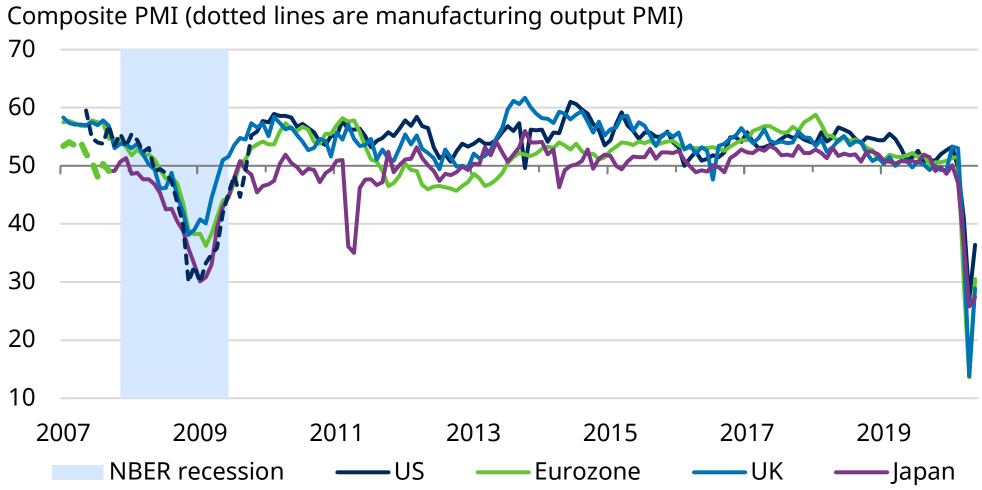
However, although welcome news it is not certain that a national R below 1 means the virus is under control. R is not the same for everyone and it may only take one group in the population, or even an individual "Typhoid Mary", to spread the disease across the whole population. The distribution of R matters (see the meaning of R) and without knowledge of how it varies across the population any prediction on the future path of the virus and hence the economy is extremely uncertain.

Meanwhile debt soars

Nonetheless, governments face a trade-off between getting the economy back to work and the health risks of people coming into contact with Covid-19. The cost of programmes to cushion the blow from unemployment and the loss of income as a result of the shutdowns is now apparent in the government borrowing figures with the US Treasury planning to borrow $3 trillion in the current quarter. Meanwhile, the UK government has borrowed more in April than it expected to borrow for the whole year before the crisis and a deficit of £300 billion is now expected for this financial year. At around 17% of GDP clearly such support is unsustainable.

There are some tentative signs of improvement in the data with the flash purchasing managers indices (PMI) bouncing back in May (chart 3). However, we would not read too much into this as the PMI readings for output and orders are weak across the board and they still signal a contraction in activity, only at a slower rate than in April.

Chart 3: Signs of a turning point?

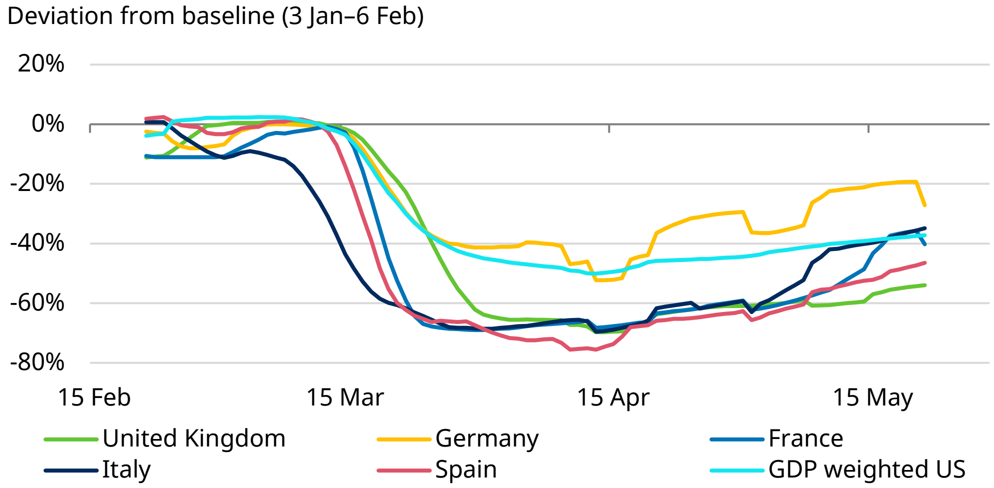


Source: Refinitiv Datastream, Schroders Economics Group. 28 May 2020. Flash PMIs for May 2020.

High frequency data says the worst is behind us

More conviction can be had from the unofficial, high frequency data which suggests that the worst may be over. For example, industrial metals prices have stabilised and Google mobility data suggests that activity in the workplace is picking up, albeit from a low level (chart 4).

Chart 4: Google mobility figures signal the worst is over



Source: Google, Schroders Economics Group. 28 May 2020.

Forecast update: the challenge of restarting the economy

Turning to our updated forecasts, this suggests that after a weak first quarter, global activity in the second quarter is likely to be as bad if not worse, as the lockdowns extended through April and into May. However, the profile through the quarter should be one of improvement as lockdowns eased toward the end of May and are expected to loosen further in June.

China, which was first into the crisis, has already experienced a bounce in activity as the nation largely returned to work in April. Others should now go through a similar process, thus creating a significant bounce in third quarter activity. In the US, for example, we expect Q3 GDP to rise 17% quarter-on-quarter (q/q) after falling 20% q/q in Q2.

Such an outcome may seem to justify the behaviour of equity markets which have rallied significantly since the end of March. There will certainly be pent up demand as consumers can make up for lost time and purchase goods and services - from cars to haircuts - from which they were shut off during the lockdown.

Weaker recovery means U replaces V

However, it is not difficult to generate large percentage changes when starting from a low base. Furthermore, compared to our previous forecast the bounce is weaker as the economy fails to regain all the ground lost in the first half of the year.

As a result, we have replaced the V-shape recovery in our previous forecast with a profile which looks more like a U. This reflects the difficulty of lifting the lockdowns amidst fears of a second wave of infection and consequently we assume that economic activity comes back more slowly than previously expected.

The economy as a light switch?

Underpinning this is a recognition that the economy is not a light switch that can be simply turned off and on. The experience of the virus will make people more cautious. In some areas, spending habits will not return for some time. For example, the travel, hospitality and leisure sectors have already acknowledged that social distancing, tighter border controls and quarantine requirements will make much activity impractical. Money saved in these areas will eventually be spent elsewhere, but this will take time.

Consumer and business caution to limit the bounce back

In addition, we might expect some more immediate consumer caution as governments begin to roll back the support provided to business. In the UK, the chancellor has already announced that the furlough scheme which is currently paying 80% of workers wages will be altered so the government pays 60%, with companies paying the remaining 20% from August. It is then likely to be phased out entirely by the end of the year. The decision is understandable given the cost, but nonetheless, changes to the scheme will add to household uncertainty over future employment, as businesses have to decide whether or not to take people back on full pay.

At the corporate level, the uncertainty over the outlook will weigh on investment and following the sharp increase in debt, we would expect a period of de-leveraging from firms as we go through 2021. This will weigh on real activity and incomes as firms prioritise debt reduction over spending on new equipment and technology or dividends.

So the government can flick the switch, but the economy will not simply revert to its pre-crisis state. Science will ultimately guide us, but visibility on activity will remain clouded as we recover from the lockdowns.

Overall we see global activity falling 5.4% this year, a downgrade from our previous forecast of -2.9% and is mainly driven by downgrades to the US and China. We expect the recovery to be gradual as households and firms remain cautious. In 2021, global growth should improve to 5.3% as fiscal and monetary policy remain loose and on the medical front a vaccine is successfully developed by mid year.

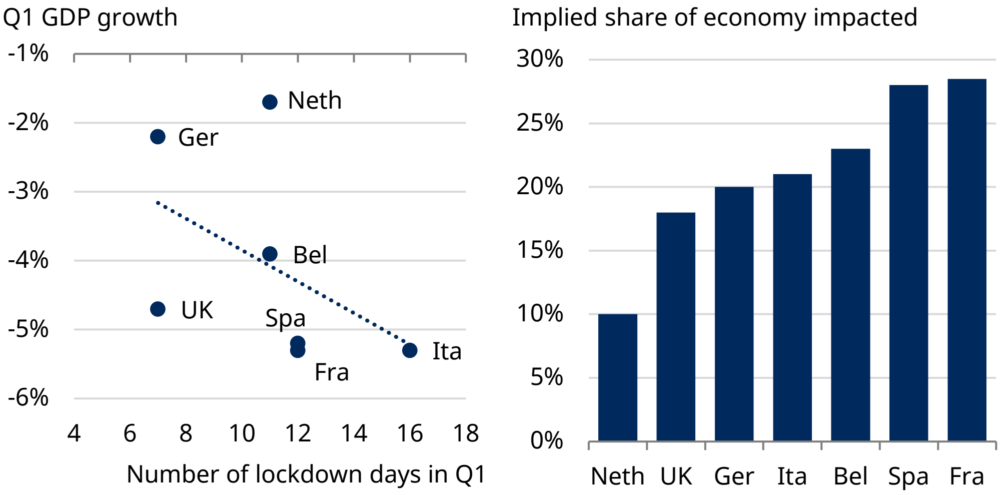
However, the level of activity is not expected to return to pre-covid levels by the end of the year as some permanent scarring effects are expected to hold back the recovery with certain sectors likely to struggle with new regulations and health requirements. Furthermore, with President Trump returning for a second term, US-China tensions are expected to rise again in 2021 as the US questions the origins of the virus and China falls short of its commitment to increase imports from the US. Another round of US tariffs are likely to be enacted at the end of 2021. On the inflation side, lower oil prices, the weaker outlook for global growth and a more persistent output gap lead us to downgrade our global inflation forecast to 1.5% in 2020 and 1.8% in 2021.

Regional views

Europe

Eurozone growth has been revised down to -6.1% from -5.7% for 2020 with the main change to the forecast driven by the new information received from Q1 GDP data (chart 5). The downward revisions were caused by the longer than expected lockdowns, however, partially offsetting this was the smaller implied share of economies being impacted. The latter is especially true for Germany (which has actually had GDP growth revised up for 2020), Italy and the Netherlands. France and Spain were largely in line with expectations (chart 6).

Charts 5 and 6: Economic hit in Europe so far



Source: Eurostat, ONS, Schroders Economics Group. 29 May 2020.

As shown from the lockdown indices in chart 1 above, most of the large member states are opening up their economies, including personal services, from 1 June. Travel restrictions have also been lifted, which is also visible from the mobility date (chart 4).

In terms of fiscal policy, Italy has been slow announcing additional measures, but the rest have largely stuck to the large packages announced at the start of the crisis. The focus of investors has shifted to support from the European Union, as several measures were unveiled in April including the provision of loans to help pay for furloughed workers, as well as loans offered from the European Stability Mechanism (ESM) fund.

EU approaches historic agreement for fiscal collaboration

Leaders also indicated plans to create an EU recovery fund, originally expected to be €1.5 - €2 trillion in size, but has been reduced to the more realistic €750 billion. This partial mutualisation of costs could prove to be the first steps towards a fiscal union, and so is being closely watched by all.

The European Commission (EC) has proposed its version of the plan, calling it "Next Generation EU". The EC plans to use the EU budget as a guarantee to be able to offer €250 billion of loans and €500 billion of "grants" - which in reality will be smaller due to the additional funding to the EU budget that will be required in the future. Between €140 billion and €280 billion would be funding from paid in capital, with the rest raised through the issuance of bonds.

Investors will be interested in Italy given its high indebtedness (see Are Italy's days in the eurozone numbered?). The plan would provide Italy with €153 billion in funding, but it would have to repay €96.3 billion over time. This amounts to a net benefit of €56.7 billion or 3.2% of GDP. Spain would receive net 6.6% of GDP, while France would pay net 2.2% of GDP while Germany pays 3.9% of GDP. The biggest winner would be Hungary which would receive an astonishing 22.4% of GDP net of payments.

Assuming the plan is backed, funding would begin in 2021, and be disbursed over four years. Repayment would not begin for some time, and probably average around 20 years.

The plan will now be discussed at the next EU summit in July, with the hope that it could be passed along with the EU's Multiannual Financial Framework. However, the vote requires unanimous backing, and though Germany has yielded, there are four member states holding out: Austria, Sweden, Denmark and the Netherlands - dubbed the "Frugal Four". If they cannot be persuaded to give up between 3.5% and 3.9% of their GDP to help, then the whole plan could collapse in the coming months.

The ECB faces a challenge to justify its QE programme

As for monetary policy, the European Central Bank will need to respond to the ruling from Germany's Constitutional Court that the resumption of quantitative easing at the end of last year was in part in breach of the German constitution. In particular, the ruling states that the policy change was not properly justified, and that there should be a timeframe to indicate when the purchases will end, and the bonds sold back to the market, rather than remaining open-ended.

The court has given the ECB three-months to respond, otherwise it may compel the German Bundesbank to halt its participation, or even force the sale of its holding of German bunds. This could potentially be very damaging to bond markets in Europe. Bunds are seen as the safest government bonds in Europe, and therefore act as a benchmark for other bonds to be priced against. If bund yields rise, we could see yields rise elsewhere, undoing the ECB's efforts to lower the cost of borrowing for governments.

As a result of the pressure from the court, the ECB is expected to maintain its current generous policy stance and stimulus programme. However, this may come across as a disappointment for many investors that are hoping for even more stimulus.

UK

In the UK, GDP growth has been downgraded from -7.2% to -8.5% for 2020. As with Europe, the main change is driven by the new information received from the Q1 GDP release. Meanwhile, the UK CPI forecast has been lowered from 1.3% to 1% for 2020, partly due to the further falls in energy prices, but also as a result of the increased slack in the economy following the GDP forecast update.

As for fiscal policy, after various extensions of support schemes, the government appears to be focused on weaning the economy off the support line (see earlier reference to the furloughed worker scheme). As support is slowly withdrawn, some companies may find that their business models are no longer viable, raising the risk of a second wave of rising unemployment later in the year.

As UK growth is downgraded, the BoE flirts with negative interest rates

With regards to monetary policy, the Bank of England (BoE) managed to dodge presenting an official forecast in the last Monetary Policy Report, instead creating an illustrative scenario. Two members of the committee voted to increase quantitative easing by £100 billion, and we expect them to be joined by the majority at the next meeting to raise purchases to a total of £745 billion. Interestingly, the debate over negative interest rates has returned as new governor Andrew Bailey recently admitted that the policy is being reviewed. We remain sceptical over its usefulness in anything other than devaluing the currency. Given its track record, one could argue that sterling does not need any help in depreciating.

Japan

Japan has already suffered two consecutive quarters of falling growth, but the impact of the shutdown along with the hit on exports means the worst quarter is yet to come in Q2. We expect the economy to contract by 9.5% q/q - faring better than most of its developed market counterparts - reflecting a lower scale of shutdown and strong government support.

After ending lockdown earlier than expected, households and businesses are now set to resume activity. Despite the help of significant fiscal stimulus (10% GDP, plus 6% more announced at time of writing), we expect the recovery to be gradual as consumers and firms remain cautious against a backdrop of deflation and weak global trade. Nonetheless, strong balance sheets in the corporate sector and relatively low unemployment due to strict employment laws should mean relatively little permanent damage is done. April data showed that official unemployment only edged up by 0.1% to 2.6%. Including furloughed workers, "unemployment" reached 11.4% - significantly lower than equivalent estimates in the US and the UK.

Lower oil prices, wages and more spare capacity should result in deflation. Though temporary and troughing at the end of 2020 at -2.5% y/y, inflation remains negative through our forecast horizon. Meanwhile, the Bank of Japan, should continue expanding its balance sheet by purchasing government and corporate bonds along with Exchange Traded Funds.

Emerging markets struggle to offset the viral impact

The biggest change to our emerging markets (EM) forecast is our outlook for China. In our last forecast round, although we knew that China would have a bad first quarter, we were uncertain whether the GDP data would accurately reflect reality. The smoothed nature of Chinese GDP is well known and the kind of drop implied by the loss of working days alone in Q1 could have been concealed by this tendency in the data. We tried to convey this at the time through our forecast for our in house activity indicator, which we saw falling by much more than official GDP. In the event, however, first quarter GDP printed a 6.8% y/y contraction, more in line with our activity indicator than with our expectations for official GDP.

China downgraded as data begins to reflect reality

This impacts not just our first quarter numbers but our expectations for Chinese GDP data going forward. The authorities seem more willing to allow bad news to be reported, if only because it is unavoidable, and this means our forecast for GDP can incorporate greater volatility. This assumption has been reinforced by the recent dropping of the growth target for 2020. Consequently, we revise our Chinese growth forecast sharply lower for 2020 to 2.2% from 5%.

The rest of the BRIC economies also receive downgrades, in part because they have had to impose longer lasting lockdowns than we had previously anticipated and in part because globally we are now assuming a more protracted recovery, which has consequences for trade. On the first point, it is worrying how badly India, Russia and Brazil particularly seem to be faring in dealing with the virus. In some cases this reflects a lack of state capacity, and economies less suited to cope with lockdown than developed market counterparts. But for Brazil in particular there has been an inexcusable political failure which gives us reason to worry about longer lasting damage.

More aggressive lockdowns and worse virus outbreaks see other BRICs revised lower

The policy response in most of the BRIC economies has been necessarily more restrained than in developed markets, with fiscal resources often already stretched and central banks unable to offer as much unorthodox support for fear of currency depreciation. All the same, the monetary response has been the more aggressive element with larger rate cuts than consensus had expected, and some form of QE has appeared in many emerging markets. Brazil has even enacted legislation to permit it for the first time.

Fiscal space though is limited, notwithstanding big headline announcements which often turn out to be less impressive than originally touted. India, for example, announced a package worth over 10% of GDP, which contained only 1% of GDP in new, direct fiscal support rather than credit guarantees or liquidity injections. China is the standout in this regard, announcing increased direct fiscal support for the economy of around 3.6% of GDP at its annual policy meeting, on top of an existing 1.2% already implemented. Coupled with a planned surge in credit this should be enough to stabilise the economy through the tried and tested route of infrastructure stimulus. We would note that though the official growth target has been scrapped, an implicit target remains, underpinning the new goal of maintaining unemployment at 6%. The authorities retain the option of further stimulus if this looks in jeopardy.

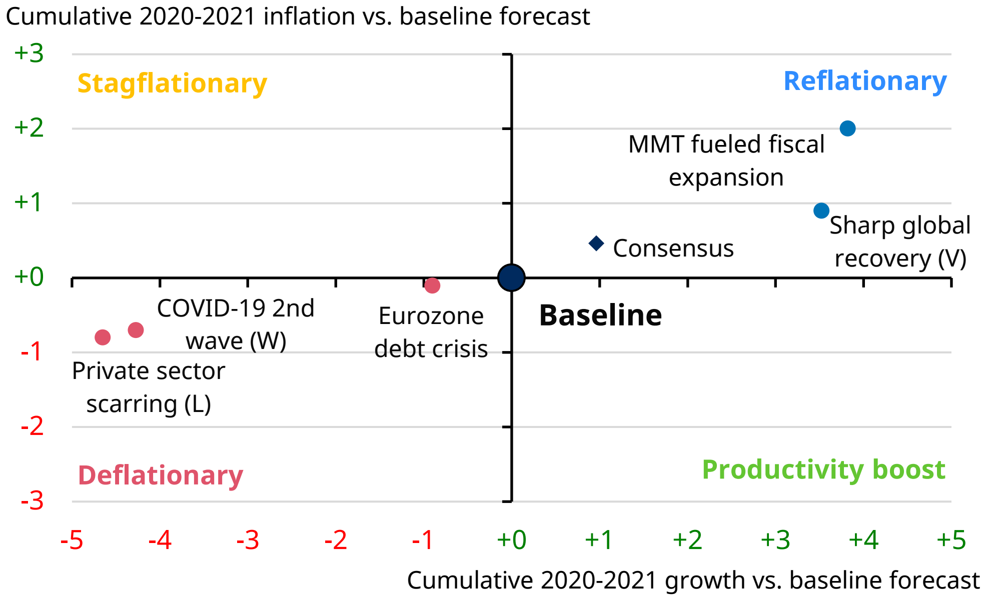
Scenario analysis

Our scenarios can be divided into two groups: those that capture different paths from the lifting of the lockdowns and those that relate to second round reactions to the crisis. In the first group we have the different letter shaped recoveries (V, W and L) with the W being driven by a return of Covid-19 and the re-imposition of lockdowns creating a double dip recession. The V is our previous February baseline and the L reflects a much more severe increase in private sector caution which keeps activity weak for longer. In the second we have a eurozone debt crisis where Italy has to receive special funding from the ESM and an increase in fiscal spend financed directly by printing money (MMT fuelled fiscal expansion).

In terms of the impact on activity (chart 7) the W and L scenarios are the most deflationary with both output and inflation weaker than the baseline. On the other side MMT fuelled fiscal expansion and the V-shape recovery are more reflationary with the money printing MMT adding to inflation as, unlike QE, the increase in money supply is fed directly into the economy rather than becoming trapped in the banking system.

Full details of each scenario can be found in the table at the back of the document (see page 12).

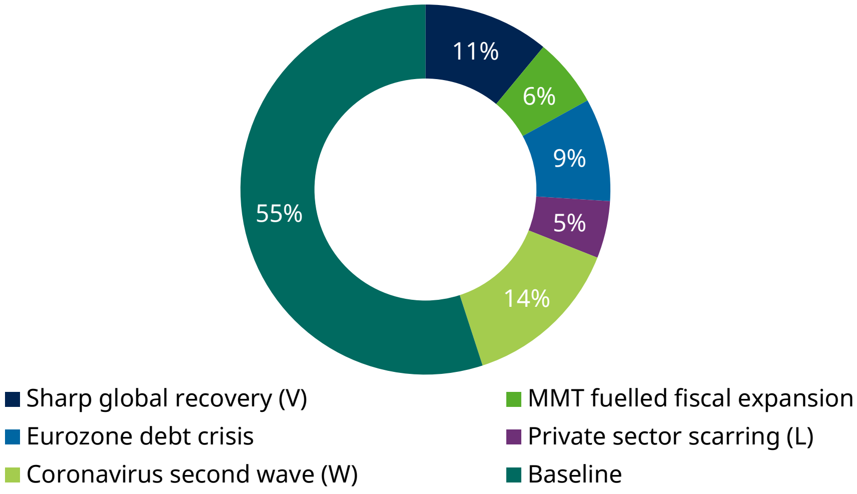
Chart 7: Risks around the baseline



Source: Schroders Economics Group. 28 May 2020.

In terms of the likelihood of these scenarios we see the W shape as the greatest risk with a number of scientists warning of the high chance of the virus returning later in the year. The V-shape recovery is the next highest with the virus remaining subdued and the private sector responding more positively to the lifting of lockdowns and the easing of fiscal and monetary policy. The eurozone debt crisis is our third greatest risk and with lower risks being attached to the remaining scenarios (chart 8), our balance of macro risks is skewed in a deflationary direction.

Chart 8: Scenario probabilities



Source: Schroders Economics Group, 28 May 2020.

Schroders Economics Group: Views at a glance

Macro summary – June 2020

Key points

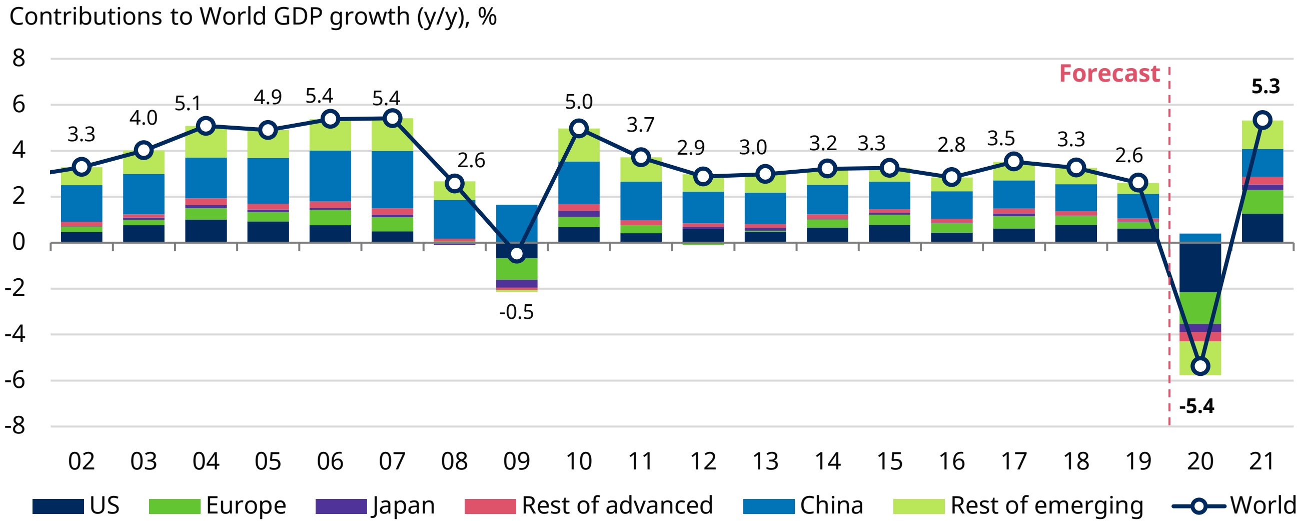
Baseline

- Overall we see global activity falling 5.4% this year, a cut from our previous forecast of -2.9% and is mainly driven by downgrades to the US and China. We expect the recovery to be gradual as households and firms remain cautious. In 2021, global growth should improve to 5.3% as fiscal and monetary policy remain loose and on the medical front a vaccine is successfully developed by mid year.
- US growth is expected to fall by 8.2% in 2020 with declines concentrated in the first half of the year. As the lockdown is lifted and business restarts, activity should bounce back in the second half. However, significant parts of the economy will continue to struggle and activity is not expected to return to its pre-covid level before end 2021. Lower oil prices and a significant output gap keep inflation below 2% over the forecast period allowing the Fed to keep interest rates at 0.25% (upper limit) and add more than $1tn in QE.
- Eurozone growth is expected to fall by 6.1% in 2020 as the lockdown takes its toll in the first half of the year, before a modest recovery in the second half of the year. Growth of 4.6% in 2021 reflects a gradual recovery, and the absence of a second lockdown. Eurozone inflation is likely to fall below zero in 2020, but average 0.4% over the year. This is driven mainly by lower energy prices. Inflation is forecast to then rise to 1.4% in 2021, but this is sufficiently weak to keep ECB QE going through to the end of the forecast period, albeit with a slower pace of purchases. Interest rates are forecast to remain unchanged.
- With a higher fatality rate and longer lockdown, the UK economy is forecast to have one of the deepest downturns, as GDP is likely to fall 8.5% in 2020 before rising 6% in 2021. The UK is expected to negotiate a partial free trade agreement with the EU covering some sectors that comes into force from 2021. Inflation is expected to fall to 1% in 2020 due to lower energy prices, weaker growth, but a weak currency helps raise inflation to 1.9% over 2021. The BoE is forecast to keep interest rates on hold and increase QE purchases to £745bn.
- With a lower scale shutdown and strong government support (40% GDP), Japan is expected to have one of the least deep downturns as GDP falls by 5.4% in 2020. Low unemployment and strong corporate balance sheets should mean relatively little permanent damage and fiscal support should help growth recover to 3.8% in 2021. Meanwhile, the BoJ are expected to keep interest rates on hold and continue QE as inflation goes into negative territory from the second quarter.
- We expect an outright contraction in EM economies in 2020 of 2.8%. After a terrible first quarter, China should see a modest rebound but is unlikely to see strong growth for the year as a whole; we expect 2.2% growth in 2020, recovering further to 6.9% in 2021. Inflation is already falling fast in many EM countries, helped by the collapse of oil prices. We expect inflation of 3.3% in 2020 with the weakness focused in the second half of the year and unwinding only modestly in 2021. On the policy side, we expect a melange of different rate cuts in China (benchmark rate, RRR, medium term lending facility and loan prime rate) as well as fiscal spending on infrastructure following the latest policy meeting.

Risks

- The overall balance of probabilities are skewed in a deflationary direction, largely as a result of the W (second wave) and L-shape scenarios.

Chart: World GDP forecast



Source: Schroders Economics Group, 28 May 2020. Please note the forecast warning at the back of the document.

Schroders Forecast Scenarios

			Cumulative 2020/21 global vs. baseline		
Scenario	**Summary**	**Macro impact**	**Probability***	**Growth**	**Inflation**
Baseline	Global GDP growth in 2020 has been downgraded from -2.9% to -5.4%, mainly driven by large downgrades to the US and China, though the latter reflects the poor but realistic Q1 data. Lockdowns cause global growth to fall sharply in Q2 but as economies reopen in Q3, GDP recovers. We expect the recovery to be gradual as households and firms remain cautious. In 2021, global growth should improve to 5.3% as slower growth in advanced economies is offset by a stronger rebound in emerging markets. In mid-2021, a vaccine is found but with President Trump returning for a second term, US-China tensions are expected to rise soon after as the US questions the origins of the virus and China falls short of its commitment to increase imports from the US. Another round of US tariffs are enacted at the end of 2021. Following the transition period, the UK moves on to a new trade arrangement with the EU, with trade-offs between sectors. On the inflation side, lower oil prices and a worse outlook for global growth lead us to downgrade our global inflation forecast to 1.5% in 2020 and 1.8% in 2021.	The global economic recovery is a gradual one. In many economies, including the US and Europe, the level of GDP does not reach pre-COVID19 levels by the end of 2021. Therefore monetary policy remains easy. The Fed, ECB, BoE and BoJ are expected to keep interest rates on hold through the rest of 2020 and 2021 but continue quantitative easing. China is still forecast to lower its rates to 3.5% by the end of 2020 and 3% by the end of 2021 and the RRR is expected to fall to 9% by the end of 2021, while more fiscal stimulus is expected in light of the hit to growth and employment. The rest of EM is more constrained fiscally, though central banks will continue to cut rates to new lows. The USD is still expected to weaken in 2020.	55%	-	-
1. Sharp global recovery (V)	Global activity rebounds sharply in the second half of 2021 as economies reopen and things go "back to normal". Fiscal and monetary policy prove very effective in boosting growth once economies open up. There is strong pent up demand from households with little evidence of a scarring and government policies are successful in little output being lost permanently. This is the closest scenario to a "V shape" recovery.	Reflationary: Economies see growth surpassing pre-COVID19 levels in the second half of 2021 and inflation also rises. In some countries, such as the US, UK and China, monetary policy is forced to tighten before the end of 2021.	11%	+3.5%	+0.9%
2. MMT fueled fiscal expansion	With no other ammunition left, central banks begin to engage in Modern Monetary Theory (MMT), the direct monetary financing of fiscal policy. Fiscal policy becomes much more aggressive, and while the ECB refrains from MMT, authorities join their counterparts in boosting fiscal spending. The additional fiscal spending and transfers help lift demand and in turn, the global economic recovery.	Reflationary: The rapid rise in money supply, combined with aggressive fiscal spending boosts growth and in particular, inflation. Inflation expectations rise and commodity prices spike as investors fearing inflation shift to the asset class. In turn, this pushes up producer prices and inflation to levels not seen in decades for most countries. US inflation peaks at 4.1% in 2021. Monetary policy remains loose, but we would expect a change in personnel at the Fed and other central banks as policy moves in an unorthodox direction. The eurozone is the exception as the ECB is forced to hike in 2021.	6%	+3.8%	+2.0%
3. Eurozone debt crisis	Markets decide that they will not fund the huge increase in borrowing from Italy once fiscal and monetary support reaches its end. At the end of 2020, BTP yields start to rise, effectively shutting Italy out of capital markets. Contagion starts to spread as other member states face funding pressure along with some banks. After huge political uncertainty, Italy is persuaded to take an ESM bailout, helping to activate OMT purchases by the ECB. Italy is forced to restructure its debt, including terming-out bonds maturing in the next three years and forcing haircuts.	Deflationary: Political uncertainty drags on growth. Italy sees GDP 5ppt lower compared to the baseline, while the wider eurozone sees a 2ppt hit. The euro plunges below parity against the USD, making this a stagflationary scenario for the eurozone, but a deflationary scenario for the global aggregate as commodity prices are also lower.	9%	-0.9%	-0.1%
4. Private sector scarring (L)	The development of a vaccine is delayed to the end of 2021. In the meantime, demand does not pick up even as economies come out of lockdown. Households decide to keep raising their savings in the fear of a second wave or another rainy day, reducing demand in the economy. Firms, faced with structurally lower demand start to pull out of certain markets, as capex remains depressed. This is the closest scenario to an “L shape” recovery.	Deflationary: Despite the best efforts of fiscal and monetary policy makers, no amount of stimulus will lift demand. The world economy falls into secular stagnation as growth rate does not return to pre-COVID19 levels. Inflation falls close to 0% by the end of 2021 and the eurozone falls into deflation.	5%	-4.7%	-0.8%
5. COVID-19 2nd wave (W)	Economies reopen too quickly and a second outbreak of the virus at the end of 2020 prompts another wave of lockdowns. These are more stringent and last longer than the first, but as a vaccine is developed in 2021, the global economy begins to tepidly recover in the second half of the year. This the closest scenario to a "W shape recovery"	Deflationary: Growth is very badly hit in 2020 and is 5.5ppt lower than the baseline. Inflation is also dragged lower owing to further weakness in demand and falling commodity prices. Global growth in 2021 is stronger than the baseline, but not enough to offset the hit from the previous year. Through this scenario, policy makers have no choice but to further loosen fiscal and monetary policy.	14%	-4.3%	-0.7%
6. Other			0%	-	-

Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2019	2020		Prev.	Consensus	2021		Prev.	Consensus
World	100	2.6	-5.4	↓	(-2.9)	-4.4	5.3	↓	(6.9)	5.3
Advanced*	61.4	1.7	-7.0	↓	(-4.7)	-6.3	4.7	↓	(7.5)	4.8
US	26.4	2.3	-8.2	↓	(-3.9)	-5.4	4.8	↓	(9.1)	4.3
Eurozone	17.6	1.2	-6.1	↓	(-5.7)	-7.9	4.6	↓	(7.1)	6.2
Germany	5.1	0.6	-4.5	↑	(-6.5)	-6.3	3.7	↓	(7.2)	5.2
UK	3.7	1.4	-8.5	↓	(-7.2)	-7.9	6.0	↓	(10.3)	6.1
Japan	6.4	0.7	-5.4	↓	(-4.4)	-5.6	3.8	↓	(4.2)	2.4
Total Emerging**	38.6	4.0	-2.8	↓	(-0.1)	-1.3	6.4	↑	(5.8)	6.2
BRICs	25.5	5.0	-2.2	↓	(1.8)	0.0	7.4	↑	(6.0)	7.1
China	17.5	6.1	2.2	↓	(5.0)	1.4	6.9	↑	(6.0)	8.1

Inflation CPI

y/y%	Wt (%)	2019	2020		Prev.	Consensus	2021		Prev.	Consensus
World	100	2.5	1.5	↓	(1.9)	1.7	1.8	↓	(2.1)	2.1
Advanced*	61.4	1.4	0.4	↓	(0.9)	0.5	0.8	↓	(1.3)	1.3
US	26.4	1.8	0.6	↓	(1.3)	0.7	0.8	↓	(1.2)	1.8
Eurozone	17.6	1.2	0.4	↓	(0.6)	0.3	1.3	↓	(1.5)	1.1
Germany	5.1	1.3	0.6	↓	(0.7)	0.6	1.4	↓	(1.8)	1.4
UK	3.7	1.8	1.0	↓	(1.3)	1.0	1.9	↓	(2.2)	1.4
Japan	6.4	0.5	-0.9	↓	(0.3)	-0.4	-1.3	↓	(0.2)	0.1
Total Emerging**	38.6	4.2	3.3	↓	(3.4)	3.7	3.4		(3.4)	3.3
BRICs	25.5	3.3	2.7	↓	(3.2)	3.2	2.6	↑	(2.4)	2.5
China	17.5	2.9	2.8	↓	(3.1)	3.1	2.2		(2.2)	1.9

Interest rates

% (Month of Dec)	Current	2019	2020		Prev.	Market	2021		Prev.	Market
US	0.25	1.75	0.25		(0.25)	0.30	0.25	↓	(0.75)	0.23
UK	0.10	0.75	0.10		(0.10)	0.17	0.10	↓	(0.75)	0.13
Eurozone (Refi)	0.00	0.00	0.00		(0.00)	-0.40	0.00		(0.00)	-0.44
Eurozone (Depo)	-0.50	-0.50	-0.50	↑	(-0.60)		-0.50	↑	(-0.60)	
Japan	-0.10	-0.10	-0.10		(-0.10)	-0.03	-0.10		(-0.10)	-0.04
China	4.35	4.35	3.50		(3.50)	-	3.00		(3.00)	-

Other monetary policy

(Over year or by Dec)	Current	2019	2020		Prev.	Y/Y(%)	2021		Prev.	Y/Y(%)
US QE ($Tn)	4.0	4.2	5.7	↑	(4.7)	35.7%	5.9	↑	(4.9)	3.5%
EZ QE (€Tn)	2.4	2.4	3.5		(3.5)	45.8%	3.8	↑	(3.7)	8.6%
UK QE (£Bn)	422	435	745	↑	(645)	71.3%	745	↑	(645)	0.0%
JP QE (¥Tn)	557	573	694	↑	(607)	21.1%	734	↑	(647)	5.8%
China RRR (%)	13.50	13.00	9.00		9.00	-	9.00		9.00	-

Key variables

FX (Month of Dec)	Current	2019	2020		Prev.	Y/Y(%)	2021		Prev.	Y/Y(%)
GBP/USD	1.22	1.32	1.26		(1.26)	-4.9	1.28		(1.28)	1.6
EUR/USD	1.09	1.12	1.10	↓	(1.13)	-2.0	1.08		(1.08)	-1.8
USD/JPY	107.8	108.7	107		(107)	-1.5	107	↑	(104)	0.0
EUR/GBP	0.90	0.85	0.87	↓	(0.90)	3.0	0.84		(0.84)	-3.4
USD/RMB	7.10	6.97	7.21		(7.21)	3.5	7.50	↓	(7.71)	4.0
Commodities (over year)										
Brent Crude	36.2	64.2	35.9	↓	(41.9)	-44.1	36.4	↓	(43.1)	1.5

Source: Schroders, Thomson Datastream, Consensus Economics, May 2020

Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.

Market data as at 21/05/2020

Previous forecast refers to March 2020

* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, United Kingdom, United States.

** **Emerging markets**: Argentina, Brazil, Chile, Colombia, Mexico, Peru, China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan SAR, Thailand, South Africa, Russia, Czech Rep., Hungary, Poland, Romania, Turkey, Ukraine, Bulgaria, Croatia, Latvia, Lithuania.

Updated forecast charts – Consensus Economics

For the EM, EM Asia and Pacific ex Japan, growth and inflation forecasts are GDP weighted and calculated using Consensus Economics forecasts of individual countries.

Chart A: GDP consensus forecasts

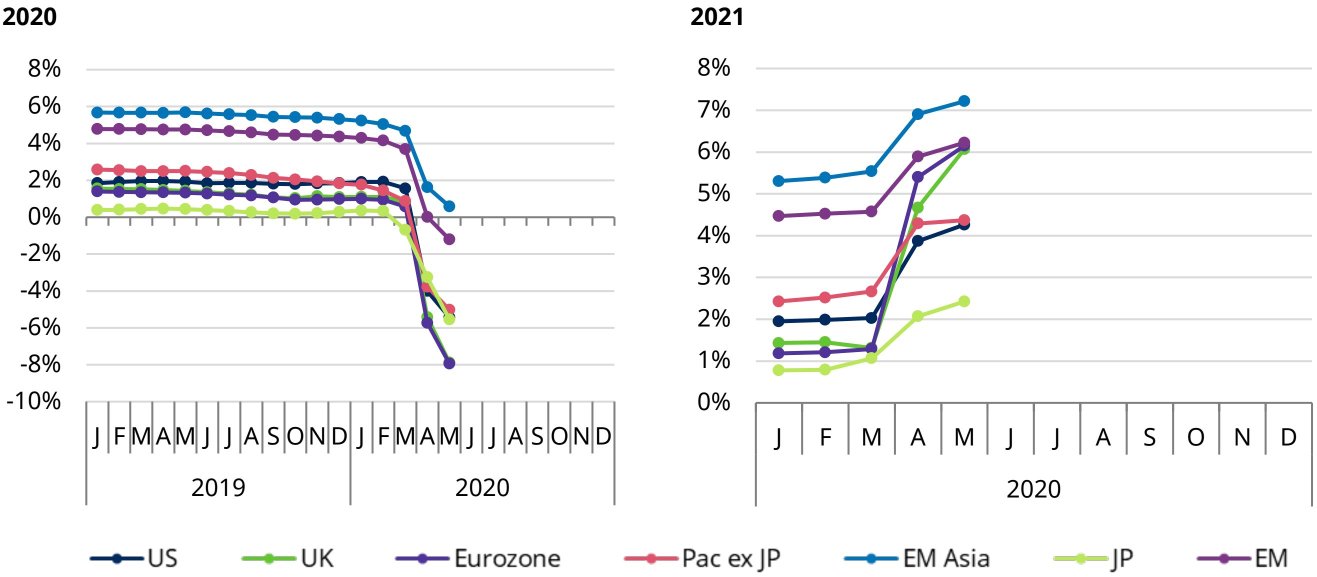
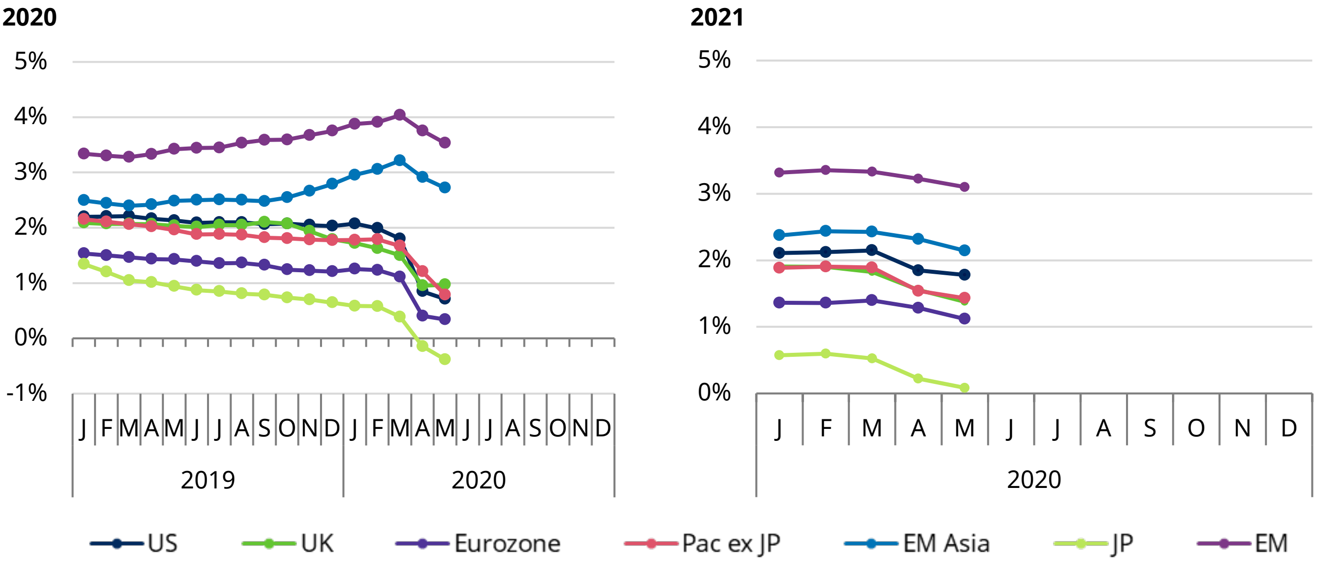


Chart B: Inflation consensus forecasts



Source: Consensus Economics (28 May 2020), Schroders.
Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore.
Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand.
Emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, Argentina, Brazil, Colombia, Chile, Mexico, Peru, South Africa, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Bulgaria, Croatia, Estonia, Latvia, Lithuania.

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