Swiss Re Institute

Economic and financial risk insights

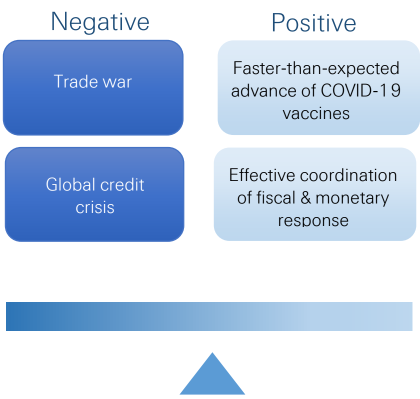
Group Economic Research & Strategy, 10 December 2020

"We expect a year of global recovery in 2021, but also the start of redistributive policies. Global growth will be subdued at first, given the most serious wave of COVID-19 yet is under way, but should rebound in the second quarter of 2021."

Jérôme Haegeli, Group Chief Economist

Key takeaways:

- **Global growth momentum will slow in the short term** as the US and Europe are challenged by COVID-19 waves. **China is set to continue to lead the recovery.**
- **Economic recovery will come in 2021**, **with temporary but notable inflation rises in H1.**
- **The recovery will be protracted and fragile as much of the structural damage to economies is already done.**
- **Elections and political events are key to watch for in 2021**, including the Georgia Senate run-off in January.
- **Risks to the outlook are balanced overall** due to positive vaccine developments.
- Watch our monthly [outlook video.]



Risk landscape: What's new?

- **Soft data in the near term, but watch out for base effects:** The pandemic's resurgence will continue to challenge the US and European recoveries in the short term and we expect some relatively subdued economic growth prints as a result. Inflation readings will also remain soft until around March. However, base effects will then come into play, which will translate into notable increases in inflation that may well temporarily exceed 2% by around May. While there are few signs of self-sustained rises in inflation globally given the size of output gaps, we continue to believe that the medium-term risk of higher inflation has increased as a result of COVID-19.
- **A protracted recovery in the making:** We continue to expect a protracted and fragile recovery in 2021, with China's recovery more advanced and more complete compared to advanced economies. While next year's GDP growth will be supported by positive vaccine news, much of the structural damage to economies is already done. This includes higher debt levels, rising inequality, and lower shock absorbing capacity going forward. As a result, we remain more cautious than consensus on the economic outlook.
- **Key to watch as we enter 2021:** Political events are set to shape the economic outlook. The new UK-EU relationship is set to begin on 1 January 2021, but it seems unlikely a deal will be ratified before the current year-end. We continue to expect a "slim" deal to be agreed, but a "no deal" Brexit is still a credible outcome. In the US, a Democratic sweep of the federal government following the Georgia Senate run-off contest would result in more fiscal stimulus than in our baseline forecast and could put upward pressure on bond yields. In Europe, the EU Recovery Fund is experiencing push-back from Poland and Hungary that could cause delays, though we expect an agreement eventually. Globally, we closely monitor the announcement of redistributive policies as these have the ability to influence economic growth, inflation and financial market valuations.

Baseline view changes

In the US, economic activity has been surprisingly resilient in the fourth quarter of 2020, improving our 2020 global GDP forecast slightly to contraction of 3.9%. Elsewhere, we have adjusted our 2021 UK growth forecast downwards to 4.7% given continued restrictions on economic activity due to COVID-19. We continue to view risks to the global economic outlook as largely balanced. Medium-term inflation risks have increased, notably in the US.

Key forecasts (in %)

	Real GDP growth		Inflation		CB policy rate		10y yield	
	2020	2021	2020	2021	2020	2021	2020	2021
US	-3.6	3.5	1.1	1.7	0.13	0.13	1.00	1.00
Euro Area	-7.3	4.0	0.2	0.8	0.00	0.00	-0.40	-0.40
China	2.3	7.4	2.6	2.4	2.00	2.00	2.80	2.70

Source: Swiss Re Institute

***For questions and comments**, please email*
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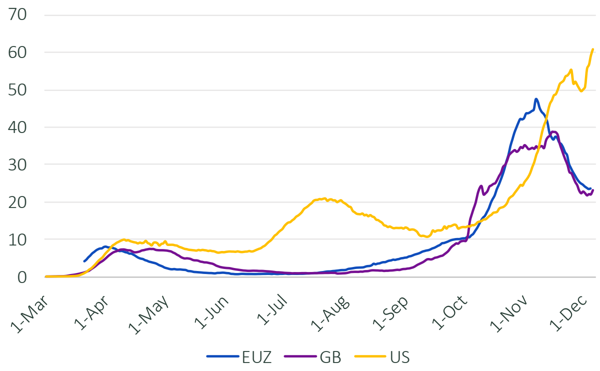
Tracking the COVID-19 recovery: high frequency indicators

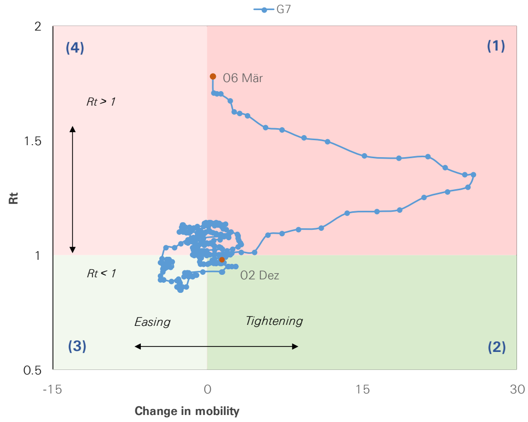
Figure 1: New cases per 100 000 people



Note: 7-day moving average of new COVID-19 infection per 100,000 population

Source: ECDC, Swiss Re Institute

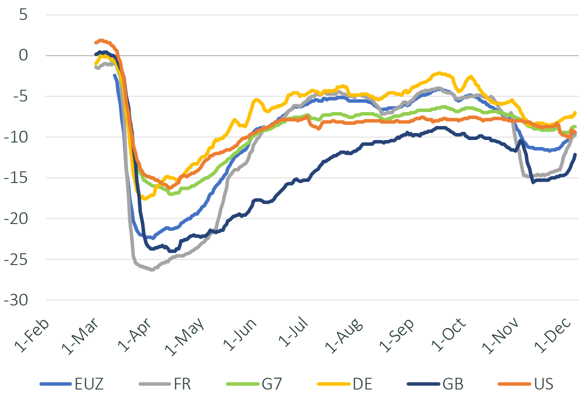
Figure 2: SRI G7 Pandemic Macro Clock over time



Note: 7-day moving-averages; Values available with a lag only. Explanation of quadrants: (1) at the start of the outbreak, infections rise exponentially (R0>1) and mobility slows on the back of lockdown measures; (2) R0 declines below 1 as new infections are contained; (3) mobility increases; and (4) infections pick up again as lockdowns are eased.

Source: Swiss Re Institute, Google, Oxford University, EpiForecasts

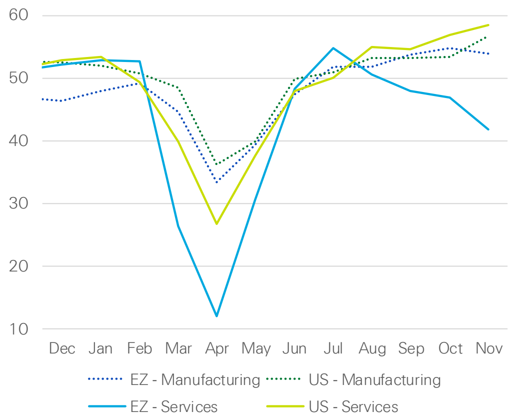
Figure 3: SRI GDP shortfall indices



Note: SRI GDP shortfall index is calculated multiplying the estimated GDP sensitivity to mobility by the google mobility index, which represents the average change in frequency of visits to workplaces, public transportation, and retail center.

Source: Thomson Reuters, Swiss Re Institute

Figure 4: PMIs for manufacturing and services



Source: Thomson Reuters, Markit, Swiss Re Institute

Global risk monitor (12-month outlook, relative to the baseline)

Risk Scenario	Explanation	Probability & Trend
Trade war	A Biden presidency will not change the US stance against China in essence. Even with a Democrat Senate, tariffs are likely to remain in place. Further trade discussions could take place in exchange for concessions from China around core issues including intellectual property and industrial policy. The trends of de-globalisation and formation of parallel supply chains are expected to continue in the medium term. **Key to watch:** bans/barriers on Chinese 5G and tech companies; tariff developments; paralell supply chains; digital taxes	**35%** =
Global credit crisis	COVID-19 vaccine developments provide potential upside risk to the global recovery and reduce the risk of a global credit crisis. The deployment of strong credit mitigation measures has helped to contain the risk of downgrades and defaults in investment grade credit. However, corporates in certain industries (e.g. SMEs, travel sector) remain under pressure. It may still be necessary in some cases to set up bad banks to absorb high risk assets and to make use of equity injection programmes to lower risks. **Key to watch:** earnings releases, credit spreads, restructuring/default rate news	**20%** =
Central bank policy error	The US Federal Reserve's change to average inflation targeting implies slower policy reactions to rising inflation, which increases inflation risks. The additional focus on broad-based and inclusive employment risks overburdening the Fed. Increasing "financial repression", and even potential debt monetisation to accommodate the massive fiscal stimulus, could raise longer-term risks associated with a loss of central bank credibility. **Key to watch:** 14-15 December: Fed meeting, 19 December: BoE meeting	**15%** =
China recession	China's near-term recession risk remains fairly low as the economy is firmly on a recovery path and Q3 GDP expanded 4.9% y-o-y. In the recently launched 14th Five Year Plan, China put technology and innovation as the centrepiece for sustainable growth, and the "dual circulation" strategy highlights the role of domestic demand in boosting growth. Deepening reforms and opening of the economy remain as key themes. Uncertainties over US-China relations, sluggish global demand and fragile business sentiment are the major headwinds. **Key to watch:** detailed sectoral plans following 14th Five Year Plan	**15%** =
Inflation risks	Headline CPI diverged across major economies with surprising strength in the US and negative inflation in the Euro area (to some extent driven by the German VAT cut). Still, short-term inflation risks are low given weakened demand due to COVID-19, which outweighed the supply shock. However, medium-term inflation risks have increased given the unprecedented fiscal stimulus and potential monetisation of debt. **Key to watch:** OPEC+ communication, 17 Dec: Eurozone HICP, 23 Dec: US PCE , 10 Dec: US CPI	**10-15%** ↑
Destabilisation of the EU/Euro area	The EU has several conflict areas, including migration policy, national budgets, and the rule of law. The agreement on the COVID-19 recovery plan and the multi-annual financial framework is a significant step for a more sustainable Europe. The extension of unemployment schemes also mitigates immediate downside risks. **Key to watch:** 10-11 December: European Council meeting; COVID-19 government responses, migration developments, ECB/EU Commission agenda	**10%** =
Stronger global growth	A potentially earlier-than-expected COVID-19 vaccine implies stronger growth (than baseline), with a swift and coordinated monetary and fiscal response across countries resulting in a faster recovery. A medium-term resolution of US-China trade disputes and tariff roll-back would also be an upside risk. **Key to watch:** application of COVID-19 vaccine, credit impulse, timing of lockdown endings, real interest rates, G20 coordination, US-China trade and tech disputes	**15%** ↑

Regional forecast overview

US:
Upward revision to 2020 growth forecast (-4.1% to -3.6%) due to stronger than anticipated bounce back in Q4. 2021 growth unchanged at 3.5%, but increased optimism due to positive developments in the vaccine front. The good news is partially offset by the weaker-than-hoped for fiscal stimulus expected to be approved.

US	2019	2020	2021	2019	2020	2021
	Real GDP (% change)			CPI (% change)		
Swiss Re Institute	2.3	-3.6 ↑	3.5	1.8	1.1	1.7
Consensus		-3.7	3.8		1.2	2.0
IMF		-4.3	3.1		1.5	2.8
	Fed Funds Rate (%)			10y Gov. Bond Yield (%)		
Swiss Re Institute	1.75	0.13	0.13	1.92	1.00	1.00
Bloomberg Consensus		0.13	0.17		0.85	1.20

Euro area:
Forecast unchanged. Some countries have started to ease their restrictions as new COVID-19 infections have peaked. However, lockdowns continue to weigh on growth, particularly in the services sector (PMI declined to 41.7 in Nov). Vaccines should lead to an improvement during the course of 2021.

Euro Area	2019	2020	2021	2019	2020	2021
	Real GDP (% change)			CPI (% change)		
Swiss Re Institute	1.3	-7.3	4.0	1.2	0.2	0.8
Consensus		-7.3	4.7		0.3	0.9
IMF		-8.2	5.1		0.4	0.9
	Refi. Rate (%)			10y Gov. Bond Yield (%)		
Swiss Re Institute	0.00	0.00	0.00	-0.19	-0.40	-0.40
Bloomberg Consensus		0.00	0.00		-0.53	-0.31

United Kingdom:
While Q3 growth was somewhat more upbeat than expected, a double-dip recession on stricter economic restrictions in Q4 leaves us with downwardly revised GDP growth for 2021. Meanwhile, we lift our 2020 CPI projection up to 0.9% (+0.2pp), due to consistently stronger than foreseen price pressures over the past months.

UK	2019	2020	2021	2019	2020	2021
	Real GDP (% change)			CPI (% change)		
Swiss Re Institute	1.3 ↓	-11.0	4.7 ↓	1.8	0.9 ↑	1.5
Consensus		-11.0	4.7		0.9	1.5
IMF		-9.8	5.9		0.8	1.2
	Bank Rate (%)			10y Gov. Bond Yield (%)		
Swiss Re Institute	0.75	0.10	0.10	0.82	0.20	0.20
Bloomberg Consensus		0.10	0.10		0.31	0.5

Japan:
Forecast unchanged. Manufacturing PMI and total export reported ongoing improvement in the past few months. Retail sales also reported its first positive year-on-year change in October (+6.4%), after seven months of contraction. However, recent COVID-19 resurgence clouds the economic outlook, which is reflected by the weakness in business sentiment, suggesting the path to full recovery would still be long.

Japan	2019	2020	2021	2019	2020	2021
	Real GDP (% change)			CPI (% change)		
Swiss Re Institute	0.7	-4.7	2.4	0.5	-0.1	0.3
Consensus		-5.5	2.5		0.0	0.0
IMF		-5.3	2.3		-0.1	0.3
	Overnight Call Rate (%)			10y Gov. Bond Yield (%)		
Swiss Re Institute	-0.07	0.00	0.00	-0.01	0.00	0.00
Bloomberg Consensus		0.00	0.00		0.01	0.05

China:
Forecasts unchanged. The recovery momentum of the Chinese economy remains robust. The official manufacturing PMI further expanded to 52.1 in December (+0.7ppt) and the non-manufacturing PMI accelerated to 56.4 (+0.3ppt), while Caixin manufacturing PMI reached a decade high. Growth of exports recorded 11.4% (yoy) in October, further supporting economic rebound.

China	2019	2020	2021	2019	2020	2021
	Real GDP (% change)			CPI (% change)		
Swiss Re Institute	6.1	2.3	7.4	2.9	2.6	2.4
IMF		1.9	8.2		2.9	2.7
	Reverse Repurchase Rate 7d (%)			10y Gov. Bond Yield (%)		
Swiss Re Institute	2.50	2.00	2.00	3.14	2.80	2.70
Bloomberg Consensus		-	-		3.16	3.09

Note: Arrows signal up-/ downward revisions from last month.

In case you missed it …

- **US Economic Outlook** (December 2020): click here for the report
- ***sigma* 07/2020**: Rebuilding better: global economic and insurance outlook 2021/2022 (11 Nov 2020): click here for the report
- ***sigma* 06/2020**: De-risking global supply chains (10 Sep 2020): click here for the report
- **Economic Insights:** US social inflation amid the COVID-19 recession – here to stay? (03 Dec 2020): click here
- **Economic Insights:** Wealth of nations: why it matters for policy makers and investors (26 Nov 2020): click here
- **Economic Insights:** Financial inclusion: an opportunity for insurers as digitalisation accelerates (19 Nov 2020): click here