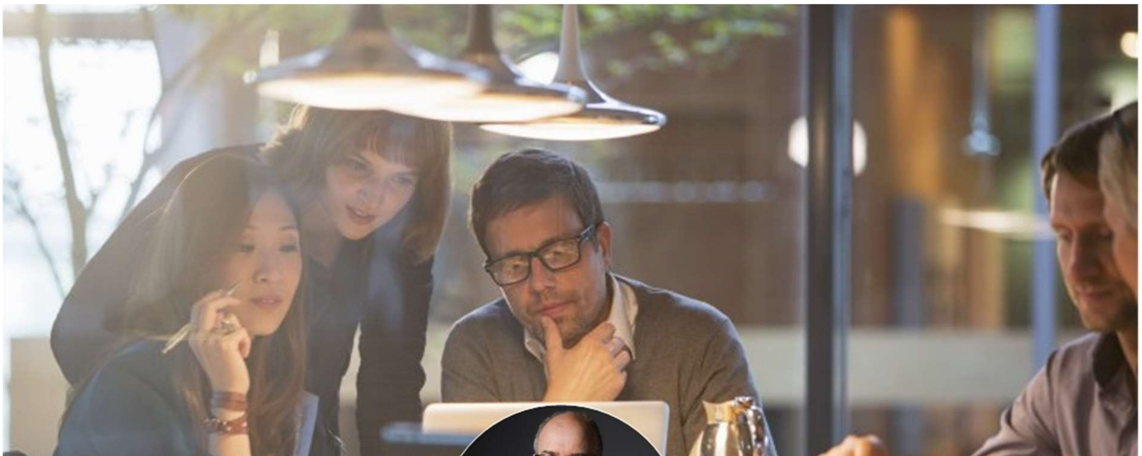
COVID-19: NEW LOCKDOWNS IN EUROPE

29 October 2020



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IN A WORD:

. The new lockdowns do not change our scenario of a rebound in growth in 2021. But the growth shape in 2020 will be different.

. We expect a strong response in terms of economic policy: more fiscal and monetary stimulus in Europe from now onwards, and in the United States after the elections.

. Take advantage of the current volatility to strengthen positions in risky assets, while diversifying geographical and sector-based bets.

In view of the very sharp rise in recent days and weeks of new Covid-19 infections, then hospitalisations, then patients in intensive care, and then the death toll in Europe, France and Germany decided yesterday (28 October) to order new national lockdowns. Other European countries, such as Italy, Switzerland and the United Kingdom, are likely to take similar decisions in the coming days, because their health situations are alike.

We had a baseline scenario where local pandemic control measures alone would have been sufficient to curb the spread of the virus, as seen in Asia, especially China and South Korea. So we are no longer in this scenario. What impact could these new lockdowns have?

Economic impact

Governments are seeking to have a more limited impact on the economy than during the first lockdown so the impact should be less severe. But the recessionary impact will be harsh on the service sectors, especially tourism, hospitality, air transport, restaurants/catering, etc. Moreover, economic agents have been through this situation before, so the adjustments will be less difficult to make. Furthermore, in the industrial sector in particular, activity picked up well in the third quarter thanks to the economic recovery in China, and in Asia generally. The shock will not be as synchronised in the fourth quarter as it was during the first lockdown.

Therefore, we are not changing our overall scenario of a rebound in growth in 2021, but rather the shape of this rebound in 2020. The third quarter is stronger than expected, notably thanks to China, while the fourth quarter will be weaker, particularly thanks to Europe. In the United States, we do not call into question the strength of the economy at this stage of the pandemic.

Policy responses

The economic impact is certainly difficult to quantify. But we have no doubt about the reaction in terms of economic policy. Monetary authorities will maintain (or even intensify) massive liquidity injections and quantitative easing. These bond-buying programmes in the markets could be increased and extended. The ECB is meeting today (29 October), so we will have the first indications. On the fiscal side, President Macron has maintained the 'whatever it takes' approach, so fiscal stimulus will remain key in Europe over the coming quarters. Similarly in the United States, we have no doubt that the Fed will pursue its monetary accommodation policy; after the elections, a new stimulus plan will most likely be voted on in Congress, regardless of the election results.

Market impact

Looking beyond the short-term volatility generated by this news, we are not changing our core message: take advantage of periods of doubt and consolidation to strengthen positions in risky assets. 2021 will be a year of an economic rebound, although the growth profile in 2020 is weaker than previously expected. Profits will be up sharply and the current earnings season reassures us on this point. Monetary policy will remain unchanged and bond yields will remain low. The famous 'TINA' (There Is No Alternative) remains intact: available cash must be directed towards investments, and with rates being so low, flows will continue to go into equity markets.

Our geographical preferences remain the United States, the emerging markets and the eurozone, in that order. It is, of course, in Europe where there is the most doubt about the extent of the correction: European markets have already corrected immensely and are historically very cheap. Our favourite sectors are pharmaceuticals, materials, industrials and insurance.

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