Monthly Newsletter Savings and Investments

Second COVID-19 wave will delay recovery while awaiting a vaccine

November 2020

Market overview

The coronavirus pandemic and the US presidential election have recently dominated economic and financial market developments. The recovery in North America and Western Europe continued in September, and incoming statistics for October have also mainly provided upside surprises. Viewed only on the basis of final statistics, we thus have reasons to paint a brighter picture now. But as the second wave of COVID-19 cases turns increasingly serious, our future perspective shifts. Restrictions and lockdowns have gradually become more extensive, especially in Western Europe. The spread of the virus has also increased in the United States, but new restrictions have mainly been regional. GDP will fall in the OECD countries; the euro area and the UK will again be hardest hit. Thanks to new stimulus and good prospects that vaccinations can soon begin, GDP will rebound next spring, but continued extreme monetary policy will be needed.

Stock market indexes' performance (until 31 October 2020)

Region	Index	Currency	Performance							
			2020 Oct	2020 YTD	12 Months	2015	2016	2017	2018	2019
USA	S&P 500	USD	-2,8%	1,2%	7,3%	-0,7%	9,5%	19,4%	-6,2%	28,9%
Europe	MSCI EURO	EUR	-6,0%	-19,5%	-17,0%	6,1%	1,7%	8,7%	-14,2%	22,0%
Eastern Europe	MSCI EM Eastern Europe	USD	-10,4%	-37,1%	-34,3%	-8,1%	33,0%	12,9%	-8,3%	26,9%
Asia	MSCI EM Asia	USD	3,3%	9,7%	18,2%	-11,8%	3,8%	40,1%	-17,3%	16,6%
Latin America	MSCI EM Latin America	USD	-1,2%	-38,1%	-35,5%	-32,9%	27,9%	20,8%	-9,3%	13,7%

Major events and expectations

Joe Biden wins the US presidential elections; what will the US be like under this president? US voters' results showed that the winner of the US presidential elections is Joe Biden. The close outcome can be expected to result in recounts and legal actions, but these are unlikely to change the outcome and financial markets have initially reacted with a sense of relief. Although the election result is not yet officially certified, it is clear that Joe Biden will be the new US president. Now there are clear hopes that American foreign and trade policies will be more predictable, which means trade negotiations with China will be pursued in a more even-tempered tone and that the risk of an imminent trade war between the US and the European Union will effectively disappear. On the domestic front, there is lingering uncertainty about what mandate the Biden administration will have, the Senate outcome will not be decided until early January, but the Republicans will probably retain their majority. However, the parties can probably overcome earlier deadlocks and reach agreement on short-term crisis responses. Further ahead, we are also likely to see new stimulus packages, though the likely Republican majority will stop portions of Biden's election programme. In the upcoming negotiations about new federal fiscal stimulus Biden may be able to expand the size of the package, but he will likely be forced to give up his plans for large corporate tax hikes, which financial markets had worried about. Stock markets reacted positively to Biden's victory – with its prospects for a more predictable foreign policy – and to the likelihood of a Republican-controlled Senate.

Second COVID-19 wave and approaching vaccine. The spread of the virus has increased sharply in recent weeks, greatly changing the short-term economic outlook. This applies especially to Western Europe, where the situation has deteriorated dramatically in large economies such as the United Kingdom, France, Italy and Spain, but also in several smaller countries. We have probably not yet seen the peak of the resulting lockdowns, they will be further expanded in November, yet at present they still appear likely to be much milder than last spring. The authorities seem to be attaching greater importance to maintaining industrial production and otherwise trying to limit damage to the supply side of the economy. But restrictions on travel, leisure activities and social life in general look set to be just as tough as last spring. The number of new infections reported in the US has also increased alarmingly in many states, but restrictions are being expanded to a much smaller extent than in Europe. Looking ahead, it is reasonable to assume that some restrictions will remain for the rest of 2020. For example, restrictions in Germany and France will initially apply for about one month (November) and can hopefully be eased at least partly over Christmas and New Year. Yet this will be conditional on ending the spread of COVID-19. If the infection curve more or less follows last spring's pattern, the peak should occur before year-end and the number of new cases will thus decrease in Q1, suggesting some economic recovery

The clock is ticking steadily towards the day the whole world is waiting for: when a vaccine against COVID-19 is available. At least ten vaccine candidates have now reached Phase 3 clinical trials, and experts believe that production and distribution can begin around year-end. This would be a major step in efforts to defeat the virus, yet there are lingering uncertainties, for example about the effectiveness and public acceptance of vaccines

On November 9, US pharmaceutical giant Pfizer announced favourable results from a large study indicated that the company's COVID-19 vaccine is 90% effective in preventing the disease, and adding that it may also be ready for use before the end of 2020. This is a very impressive effectiveness level, since expectations have been around 60-70%, and it signals that the COVID-19 virus can be stopped – which is much-needed since the pandemic is continuing at undiminished strength.

Macroeconomic outlook. We expect GDP to fall in the OECD countries during Q4 of 2020. The first months of 2021 will also be very weak. During the 2021 Q2 a clearer recovery will begin, among other things because risk groups and health care employees may have started to be vaccinated against COVID-19, judging from the actions of the public authorities in charge. Measured as annual averages, these new events will mean that we are adjusting our GDP growth forecast for 2020 upward and our forecast for 2021 downward by about the same numbers. A steeper upturn in 2021 will also help lift our 2022 full-year forecast. Our global GDP forecast is largely unchanged. This is because changes in emerging market (EM) economies are showing the opposite pattern: the impact of the pandemic in 2020 now looks larger than expected, opening the way for a more powerful recovery in 2021. However, this assumes that there will not be any clear second COVID-19 wave in Asia.

Overall, we think that the second wave will not have any crucial negative impact on GDP growth over the next few years. But it will probably lead to further crisis responses. This may worsen the long-term disadvantages of such measures as ultraloose monetary policies in the form of growing economic gaps, weak pressure for change and nonoptimal allocation of capital. As for fiscal stimulus, we cannot rule out that higher public debt will become a long-term problem.

Active fiscal policies will ease the burden on central banks. But the increasing spread of the virus will still push down resource utilisation and inflation in a way that will also trigger further monetary policy expansion. We believe central banks will choose to expand quantitative easing (QE) programmes in various ways but will want to avoid additional key interest rate cuts for as long as possible.

Corporate earnings surprises markets. Stock markets have recently been under pressure because of pandemic-related growth worries and uncertainty connected to the US presidential election. But in light of the strong recovery since last spring's crash, stock markets have shown great resilience. Predominantly favourable Q3 reports have provided support for stocks. Companies continue to show impressive cost control and flexibility. This is one reason why this year's decline in earnings has been less than feared. Expanded restrictions and lockdowns will remain a threat, but with access to COVID-19 vaccines approaching, the risk that longer-term earnings forecasts need to be downgraded will diminish. Given the prospect of very low rates and yields, we do not see today's valuations as worrisome, especially if we calculate price-earnings (P/E) ratios on the basis of earnings levels that appear reasonable once the situation has normalized to a greater extent towards the end of our forecast period.

Alternative scenarios for economic recovery. Aside to our main economic development scenario we are analyzing negative and positive scenarios.

Our negative scenario assumes that the spread of COVID-19 will be even more dramatic than we see now and that a vaccine will take longer to develop and will also be less than fully effective. If the economy is hit by broader, more long-lasting lockdowns and restrictions, it will be difficult to avoid a significant wave of bankruptcies that will be accompanied by severe financial market instability. In such a situation, it will be difficult to repeat the strong rebound that we saw when economies reopened this past summer. On the other hand, we also expect a wave of additional stimulus measures in the negative scenario.

In our positive scenario, we still see the recovery inevitably losing momentum. But some months into 2021, there is greater potential for better economic performance than in our main scenario. The arguments are largely the opposite of those in our negative scenario. The spread of the virus may be slower and the vaccination process may get started somewhat faster and also be more effective. It is also possible that we are underestimating the power of the economic policy stimulus dose when it has better conditions to have an impact, among other things because households will open their wallets and use their savings from 2020 once consumption opportunities broaden.

Forecast of GDP growth in the OECD countries in our various scenarios.

	2020	2021	2022
Main scenario	-5,6%	3.8%	3.4%
Negative scenario	-6.1%	0.8%	2.7%
Positive scenario	-5.1%	7.3%	3.9%

Source: SEB Nordic Outlook (2020 November)