

# Reviewing 2020 Risks

July 24, 2020

At the end of 2019, when we published our view on 2020, few anticipated a global pandemic. We have updated our view to take the recent months into account.

	2020		2021	
	Growth yoy%	10 Year Rates	Growth yoy%	10 Year Rates
U.S.	-4.7	0.85	3.0	1.75
Eurozone	-8.0	-0.30	5.0	0.00
U.K.	-8.0	0.50	5.0	0.85
China	2.0	2.80	6.2	3.00
Japan	-5.5	-0.10	2.4	0.00

Source: MIM

We anticipate growth to be historically low in 2020. Central banks have signaled that they will hold rates extremely low. Neither the Federal Reserve nor the European Central Bank are expected to raise rates before 2023. Ten-year yields are expected to remain modest.

On the other hand, we expect growth to rebound in 2021. Some of this is inevitable: we are unlikely to see a global lockdown as we saw in March and April, and almost any resumption of activity will look favorable.

But risks to the forecast abound. Some of the risks from our year-end 2020 view remain: U.S.-China tension risks are, if anything, even more elevated. U.S. election outcomes are similarly even more uncertain than before. Brexit, while remaining a considerable risk for Europe and in

particular the U.K., recedes somewhat in relative terms. Other geopolitical risks including Iran and North Korea have faded somewhat as COVID-19 has refocused virtually every country's priorities at least in the near term. To the list of risks we have added uncertainties about the recovery process including the evolution of COVID-19, monetary and fiscal support, as well as household and firm responses.

## Risk #1

### Unexpected changes to timeline or severity COVID-19 responses

The world is unlikely to see the same economic repercussions as it did in March and April of this year. There is a more sophisticated understanding of how to manage COVID-19, the blunt force tool of a shutdown is unlikely to be reimplemented on the same scale,<sup>1</sup> and businesses are better prepared.

However, there is a risk that a new wave of COVID-19 becomes severe enough to cause regional shutdowns. A particularly severe wave in the fall could even mean negative fourth quarter growth. Vaccines – despite widespread expectations – may not be widely available within a year. They might not be as effective or as widely adopted as expected, which would mean that consumer confidence would take longer to recover.

Upside risks include a faster than expected vaccine timeline and rapid improvement in treatment options.

Consumers and businesses could also become more resilient in the face of the ongoing pandemic. There is an imperfect correlation between the number of COVID-19 cases and their economic impact. That is, countries with less-controlled outbreaks are not necessarily suffering greater economic consequences. Playing a role in the difference are government policy responses, individual and firm-level responses, as well as the configuration of each economy relative to global supply chains and other hard-hit countries.

## Risk #2

### Volatile recovery

We expect a moderate recovery in 2021 in most regions, somewhat slower than the consensus forecast of a sharper V-shaped recovery. The economic recovery began well in the spring with a sharp rebound. This is likely to fall far short of pre-COVID 19 levels. The recovery is likely to be a volatile process, however, and forecasting is typically difficult during such an unusual time.

There is a possibility that the short-term dislocation feeds into a longer-term deepening recession. Companies may hesitate to rehire more employees until they are more certain about demand and the “new normal,” which may exacerbate consumers' income worries and further suppress demand.

A surprisingly fast recovery could also cause problems. Japan, the U.S., and the Eurozone each have combined monetary and fiscal packages worth more than 40% of their respective economies. The UK and China have packages worth just under 20% of GDP<sup>2</sup>. But policy effects, particularly on the fiscal side, tend to have a delayed impact which could lead to overheating down the line if demand begins to outstrip pared-back supply.

**Risk #3****Increased uncertainty around the U.S. election**

We flagged this as an important risk previously, and it remains one now. There is now no longer the conventional “easy” base case of an incumbent prevailing. With the deep negative shock to the economy, and with likely continued high unemployment rates through the fall, it is difficult to predict a base case. The COVID-19 recession has helped increase the probability of a Democratic victory in November. Currently (as of mid-July), the expected nominee, former Vice President Biden, has a substantial lead in national polling.<sup>3</sup> There are, however, four months to go before the Presidential election, and the high levels of forecast and COVID-19 uncertainty make a Biden win far from certain.<sup>4</sup> There is increased uncertainty about the Senate race, with an aggregate forecast showing that four Republican-held Senate seats are now tossups.<sup>5</sup>



Another possible concern is the effect of the coronavirus on the election itself. The elections may lean heavily on mail-in ballots to prevent crowding at polls. This could lead to a contested election, or at the least, a delay in the announcement of results as absentee ballots are counted. If the results are close, the courts could get involved as in the 2000 election. All of these are risks worth considering, particularly if the race becomes close in the fall.<sup>6</sup>

**Risk #4****Increased tensions between the U.S. and China**

A major continuing global risk is the U.S.-China relationship. Both the U.S. and China appear to have domestic reasons to sustain confrontation. We expect the U.S., led by President Trump but with bipartisan support, to continue to engage in “tough talk” against China, although we expect to see continued restraint in actual policy actions. Given bipartisan concern about China’s actions, we see potential for more legislative action by U.S. Congress aimed at China. China, despite its strong post-COVID 19 recovery, continues to contend with labor market fallout, and could be forced to act if U.S. actions harm its full recovery.

There are downside risks, if either President Trump or President Xi believes stronger actions would be politically favorable or if the accumulation of minor actions on either side precipitates further escalation. As a result, the Phase 1 deal could fall apart, China could implement a long-threatened “unreliable entity” list for U.S. companies, or categories of commercial companies could be restricted from either market (e.g., the tech sector). In this tense environment with little to no bilateral dialogue, a “black swan” event could spark heightened confrontation which could prove difficult to contain.

Hong Kong represents another source of tension in the U.S.-China relationship. The Standing Committee of the National People’s Congress unanimously passed a new National Security Law for Hong Kong. Critics of the law say it stifles freedom of expression and directly threatens rule of law and judicial independence in the territory. In response, the U.S. has threatened sanctions on both individuals and financial institutions (under the Hong Kong Autonomy Act) and has started removing some of Hong Kong’s special privileges under the



1992 U.S.-Hong Kong Policy Act, after U.S. Secretary of State Mike Pompeo declared Hong Kong is no longer sufficiently autonomous from the mainland.

## Risk #5

## Social Unrest Impact on Policy Actions

The U.S. is experiencing social unrest. Underlying discontentment against police brutality towards Black Americans has turned into widespread protests, perhaps amplified by economic and health uncertainties caused by COVID-19. The social unrest could persist throughout the summer.

In the U.S., any economic effects would be most likely to be felt indirectly via policy. This may be through changes to proposed policies by the President or his challenger, former Vice President Biden, although the most recently published Biden proposal does not provide an economically linked program addressing the social unrest.<sup>7</sup>

The dynamics of the COVID-19 induced recession could amplify underlying domestic concerns in other parts of the world creating an environment for social unrest elsewhere, although many countries have for now staved off large spikes in unemployment.

### Endnotes

- <sup>1</sup> A timeline of the early days of the COVID-19 pandemic demonstrates the early deficiencies in understanding of the disease and the extreme measures initially undertaken. <https://www.weforum.org/agenda/2020/04/coronavirus-spread-covid19-pandemic-timeline-milestones/>
- <sup>2</sup> The Eurozone has provided assistance of up to 43.6% of GDP, while Japan has offered up to 60.3%. "The Eco Glass Is At Least Half Full," June 21, 2020. Cornerstone Macro Economic Research.
- <sup>3</sup> Real Clear Politics' polling aggregate shows Biden with a 9.0 point lead over Trump, with a range of +4 to +12 for Biden. Fivethirtyeight.com's polling aggregate shows Biden with an 8.9 point lead, with a range of +3 to +14 for Biden since the beginning of June. Battleground states of Michigan, Pennsylvania, Wisconsin and Arizona are breaking for Biden by margins of +2.2 and +9.4, again according to fivethirtyeight.com (accessed July 13, 2020).
- <sup>4</sup> Both outcomes are seen as possible. "Trump rally highlights vulnerabilities heading into the election," June 22, 2020. Steve Peoples and Jonathan Lemire, AP News. <https://apnews.com/9d80f33ac3495997610dc14eba0f1d56>. "Pollster Nate Silver says Trump can 'absolutely win' 2020 election despite dive in polls," June 22, 2020. Joseph A. Wulfsohn, Fox News. <https://www.foxnews.com/media/pollster-nate-silver-trump-can-win-2020-election>.
- <sup>5</sup> Aggregate forecast taken from 270towin.com. <https://www.270towin.com/2020-senate-election/consensus-2020-senate-forecast> (accessed July 8, 2020) and <http://centerforpolitics.org/crystalball/2020-rating-changes/> (accessed July 8, 2020) for recent ratings changes showing most changes are directionally moving in favor of Democrats.
- <sup>6</sup> "Why Vote-by-Mail Could be a Legal Nightmare in November," Politico Magazine, Edward B. Foley, April 7, 2020. <https://www.politico.com/news/magazine/2020/04/07/danger-moving-vote-by-mail-168602>
- <sup>7</sup> "Biden: Build Back Better," Cornerstone, July 10, 2020.

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