Economic Risks

- Secondary dips in activity multiplying before vaccines arrive
- A US Presidential inauguration surrounded by chaos
- Inflation falling further and remaining uncomfortably low
- Fiscal support being extended, further boosting debt ratios
- Central banks becoming yet more unconventional
- Real activity taking many years to approach prior trend

OECD: vaccines spark hopes of a more sustainable recovery

- The easing of COVID containment measures saw OECD real GDP rise 9% q-o-q in Q3, but it was still 4.3% off the peak.
- Performance differed greatly over the course of 2020, the US proving more resilient than Canada, Europe, and Japan.
- Second infection waves are causing renewed dips in activity, but the arrival of viable vaccines promises recovery in 2021.
- Even with extensive vaccination, output in most economies is likely to fall short of the pre-crisis trend for some years.
- Bankruptcies, joblessness, inequalities, and poverty will swell in the near term, and many aspirations will not be met.
- Over time, however, reduced uncertainty and accumulated savings stand to boost consumption and investment.
- Both headline and core OECD CPI inflation remain awkwardly low at 1.2% and 1.6% respectively.
- Macro support will need to be sustained: with borrowing costs low, the case remains for boosting public investment.
- Risk asset prices have been boosted by the development of vaccines and the promise of enduring near-zero policy rates.

US: Georgia on my mind

- The US enjoyed a robust initial recovery, resilient to infection rates, electoral uncertainty, and a fiscal hiatus.
- Real GDP rose 7.4% q-o-q in Q3, while at 6.9% of the workforce, the jobless rate is less than half its 14.7% peak.
- However, evidence is building that a continued surge in infections is weighing on consumer confidence and outlays.
- The economy is at risk of stalling, if not a second dip in activity, before vaccines are widely distributed during 2021.
- As noted by the Fed, there is a strong case for further fiscal support to buttress the recovery in the months ahead.
- PCE inflation has rebounded slightly from its lows, but remains well below target at 1.2% headline, and 1.4% core.
- Financial conditions remain loose, underpinned by near-zero policy rates and the Fed's huge LSAP programme.
- The range and tone of President-elect Biden's policy agenda hinges on the January run-off for two Georgia Senate seats.
- The appointment of Janet Yellen as Treasury Secretary is the most prominent of a series of mainstream cabinet choices.

Bottom line: a temporary slowdown, if not a renewed set-back to recovery, before vaccines usher in a sustainable recovery.

Watch for: a second dip; more fiscal largesse; more QE**;** a yield curve target; a chaotic Presidential inauguration.

Euro area: deflation risks becoming embedded

- Surging infection rates and renewed lockdowns have led to further declines in real activity across Europe.
- Services confidence and output have again been especially hard hit, while both credit demand and supply are in retreat.
- Real GDP will decline in Q4, before recovering through 2021, but the fall will be less severe than during last spring.
- Vaccines or not, the authorities are bracing themselves for a wave of business failures, job losses, and pay restraint.
- Asymmetry in economic performance threatens to deepen longstanding divisions between north and south.
- Headline CPI inflation has been persistently negative over recent months, even allowing for the impact of VAT cuts.
- Second dips, deflation, tight credit, and euro strength suggest the ECB will follow the Riksbank and expand its APP.
- The EU's Recovery Plan (some 5.5% of GDP) is impressive, but currently stymied by Polish and Hungarian obstinacy.

Bottom line: a still-born recovery and an extended and significant inflation-undershoot require a big policy response.

Watch for: more negative policy rates; a more symmetrical inflation target; efforts to circumvent Poland and Hungary.

UK: goodbye Great Britain

- A slow initial response to the virus, plus inadequate testing, have left the UK with one of the world's highest death rates.
- Despite a huge fiscal response, at more than 11%, the prospective decline in 2020 GDP will be one of the largest.
- Q4 real GDP is set to retreat, and a further substantial drop is in prospect in Q1 2021 in the event of a no-deal Brexit.
- Bankruptcies and redundancies are escalating, despite extended and embellished government support.
- The harder the form of Brexit, the greater the longer-term damage to trade, productivity, jobs, and the public finances.
- With net government debt above 103% of GDP in H1, a post-1960 high, there are significant hints of tax increases.
- Even after a limited rebound in Q3, both headline and core CPI inflation remain historically, and uncomfortably, low.

Bottom line: COVID and Brexit threaten to leave the UK a conspicuous economic underperformer for some years.

Watch for: renewed recession; a negative Bank Rate; monetary finance; a loss of international confidence. Johnson replaced.

Asia and Emerging markets: defaults beckon

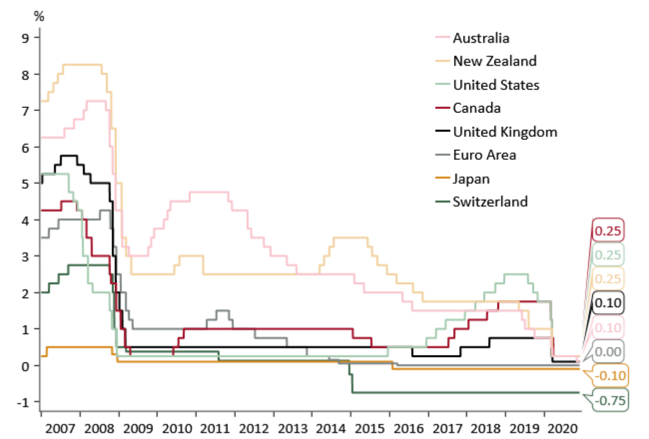
- Japan has slipped further into deflation, with wage growth now negative in y-o-y terms since the spring.
- China's recovery is gathering momentum, and its strong import demand is providing support to the rest of Asia.
- A cascade of sovereign defaults beckons, not just among LDCs, but perhaps in middle income and EM nations too.
- Poverty, together with inequality both across and within economies, stands to rise sharply in 2021.

Bottom line: China will be the only G-20 economy to expand this year; elsewhere the picture is much more heterogeneous.

Watch for: humanitarian crises; IMF packages; restructurings; defaults; SDR issuance; monetary finance; GDP-linked bonds.■

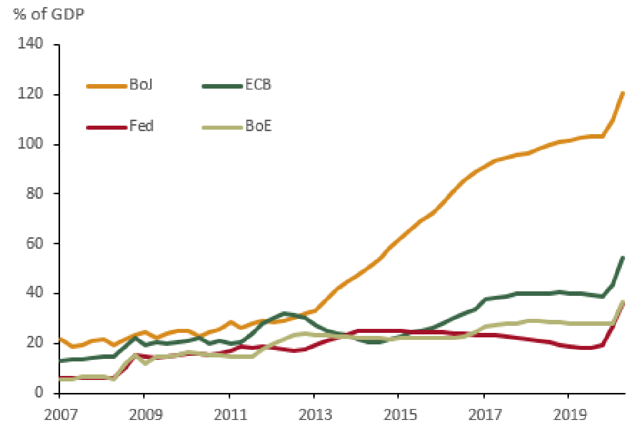
Charts of the month

Figure 1: Policy rates



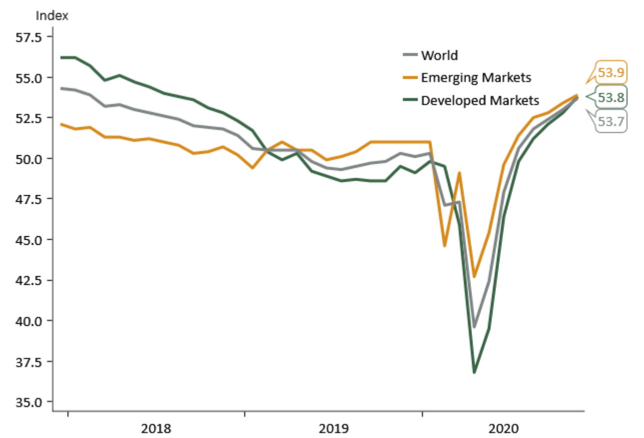
Source: Macrobond and Llewellyn Consulting

Figure 2: Central bank balance sheets, as % of GDP



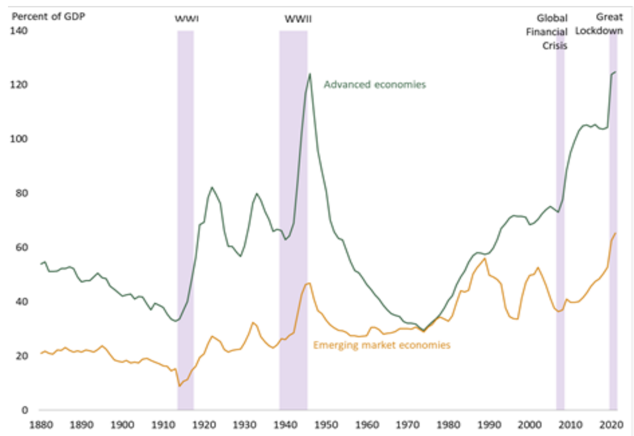
Source: Macrobond and Llewellyn Consulting

Figure 3: PMIs



Source: Macrobond and Llewellyn Consulting

Figure 4: General government debt ratio, as % of GDP



Source: IMF and Llewellyn Consulting

Recommended reading

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