COVID-19 has triggered an unprecedented sudden-stop to the global economy. The macro outlook reflects a tug-of-war between containment measures and macro-stabilisation policies. We have devised three scenarios to map the range of possible outcomes for the global economy.

Our views

Major challenges in restarting economic activity and the risk of policy under-delivery mean we are tactically cautious in our global multi-asset portfolios. But policy support so far has reduced the risk of very bad outcomes. We think longer-term investors could benefit from exposure to attractively valued asset classes.

The COVID-19 pandemic has shocked many economies in a way not seen for at least 100 years. Unprecedented government measures to suppress the COVID-19 virus have resulted in an initial supply shock, followed by a major hit to demand amid job losses, higher uncertainty and weaker confidence. The global economy has fallen into a deep recession.

Looking ahead, the outlook for the global economy can be characterised as a tug-of-war between the adverse economic impact of containment measures, mainly determined by COVID-19 developments (e.g. how the pandemic evolves and how quickly treatments and vaccines can be developed), and support from macro-stabilisation policies.

The effects of both forces are highly uncertain. We are in unchartered waters – governments have not previously "locked down" modern economies in such a draconian way, nor have they engaged in some of the macroeconomic policies that have been rolled out.

Setting out the scenarios

We have devised three broad scenarios to capture the range of possible outcomes for the global economy (Figure 1). Essentially these are a downside, central and upside scenario.

Figure 1: Our view on global growth scenarios

<table>
<thead>
<tr>
<th>Assumptions</th>
<th>Containment measures</th>
<th>Support policies</th>
<th>Result</th>
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<tbody>
<tr>
<td><strong>Stagnation</strong></td>
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<tr>
<td>Vaccine rolled out at the start of 2022</td>
<td>Partially lifted during 2020</td>
<td>Cannot prevent financial stress or a significant fall in the level of the economy’s productive capacity and long-run growth rate</td>
<td>GDP Index</td>
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<td>Slow progress in testing</td>
<td>Completely removed from Q4 2021</td>
<td></td>
<td>• Modest recovery from mid-2020</td>
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<td>Second wave of infections in Q2 2021</td>
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<td></td>
<td>• Output well below previous trend</td>
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<td><strong>Sudden stop &amp; set back</strong></td>
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<tr>
<td>Vaccine rolled out in mid-2021</td>
<td>Partially lifted during 2020</td>
<td>Cannot prevent a persistent loss of the economy’s productive capacity, but pre-virus long-run growth rate is broadly maintained</td>
<td>GDP Index</td>
</tr>
<tr>
<td>Significantly increased rate of testing</td>
<td>Completely removed from mid-2021</td>
<td></td>
<td>• Recovery starts mid-to-late Q2</td>
</tr>
<tr>
<td>Further outbreaks are isolated and contained</td>
<td></td>
<td></td>
<td>• Confidence returns gradually as restrictions are eased</td>
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<td><strong>Source:</strong> HSBC Global Asset Management, as at 12 May 2020. Any views expressed were held at the time of preparation and are subject to change without notice. <strong>Investments, annuity and insurance products</strong></td>
<td><strong>ARE NOT A BANK DEPOSIT OR OBLIGATION OF THE BANK OR ANY OF ITS AFFILIATES</strong></td>
<td><strong>ARE NOT FDIC INSURED</strong></td>
<td><strong>ARE NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY</strong></td>
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</table>
We estimate that our central scenario is materially weaker than consensus expectations

We think there is a risk of longer-than-expected containment measures and soft confidence

China has successfully suppressed COVID-19 and is re-opening its economy

Challenges in restarting economic activity and the risk of policy under-delivery means we are tactically cautious in our global multi-asset portfolios

But for longer-term investors, risky asset class valuations continue to look relatively attractive

In all three scenarios, we expect the initial hit to economic activity to be immense, with some degree of long-term damage – or scarring – to the economy. Recent data support this view. For example, US employment fell by over 20m in April, eurozone retail sales slumped 11% in March, while new car registrations dropped by over 55%. In the UK, the Bank of England suggested GDP in Q2 could fall 30% below its end-2019 level.

We estimate that our central scenario is materially weaker than consensus expectations. This is because we believe consensus numbers embed a fairly optimistic path out of containment measures. We also think there are downside risks to consumer and corporate behaviour. For example, recent surveys suggest populations are worried about catching the virus, which is likely to translate into cautious spending activity (Figures 2 and 3).

Figures 2 & 3: COVID-19 public surveys

Source: YouGov

Meanwhile, consensus expectations that China’s economy will significantly outperform in the coming quarters seem reasonable to us. This is because China seems to have successfully suppressed COVID-19 and is re-opening its economy, reflected in more typical levels of air pollution (Figure 4) and a strong rebound in PMI survey data (Figure 5).

Figures 4 and 5: Shanghai air quality, and composite PMIs


Market considerations

Our scenarios show there is a high level of uncertainty over the economic outlook. Challenges include restarting economic activity amid the virus, while we think there is a risk that macro-stabilisation policies are not supportive enough in the recovery phase. With scope for further downgrades to consensus estimates, we are tactically cautious on risky assets (such as global equities) in our global multi-asset portfolios.
However, we still think it makes sense to be overweight global equities on a longer-term, strategic basis. Our estimates of global equity valuations have improved this year, and the rollout of major policy support initiatives has lowered the probability of very bad outcomes. We thus see market falls as buying opportunities, with a preference for defensive sectors.

For **developed market (DM) government bonds**, ultra-low yields are consistent with our underweight positioning. There is uncertainty if they can act as reliable portfolio diversifiers.

Meanwhile, central bank policy support is now involving the purchase of huge quantities of **corporate bonds**. This is one reason why we are neutral in the investment grade space. Riskier high-yield bonds are also finding support from central bank policies, which combined with very attractive valuations means we hold an overweight view.

Finally, we are less positive on certain **emerging market (EM) assets** due to the risks posed by COVID-19 and less attractive relative valuations. In particular, we think EMs outside of Asia have limited capacity to manage the crisis amid weak healthcare systems and low commodity prices. On the other hand, EM Asian markets have more scope to benefit from a growth recovery in China and are generally less vulnerable to international investor sentiment.

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