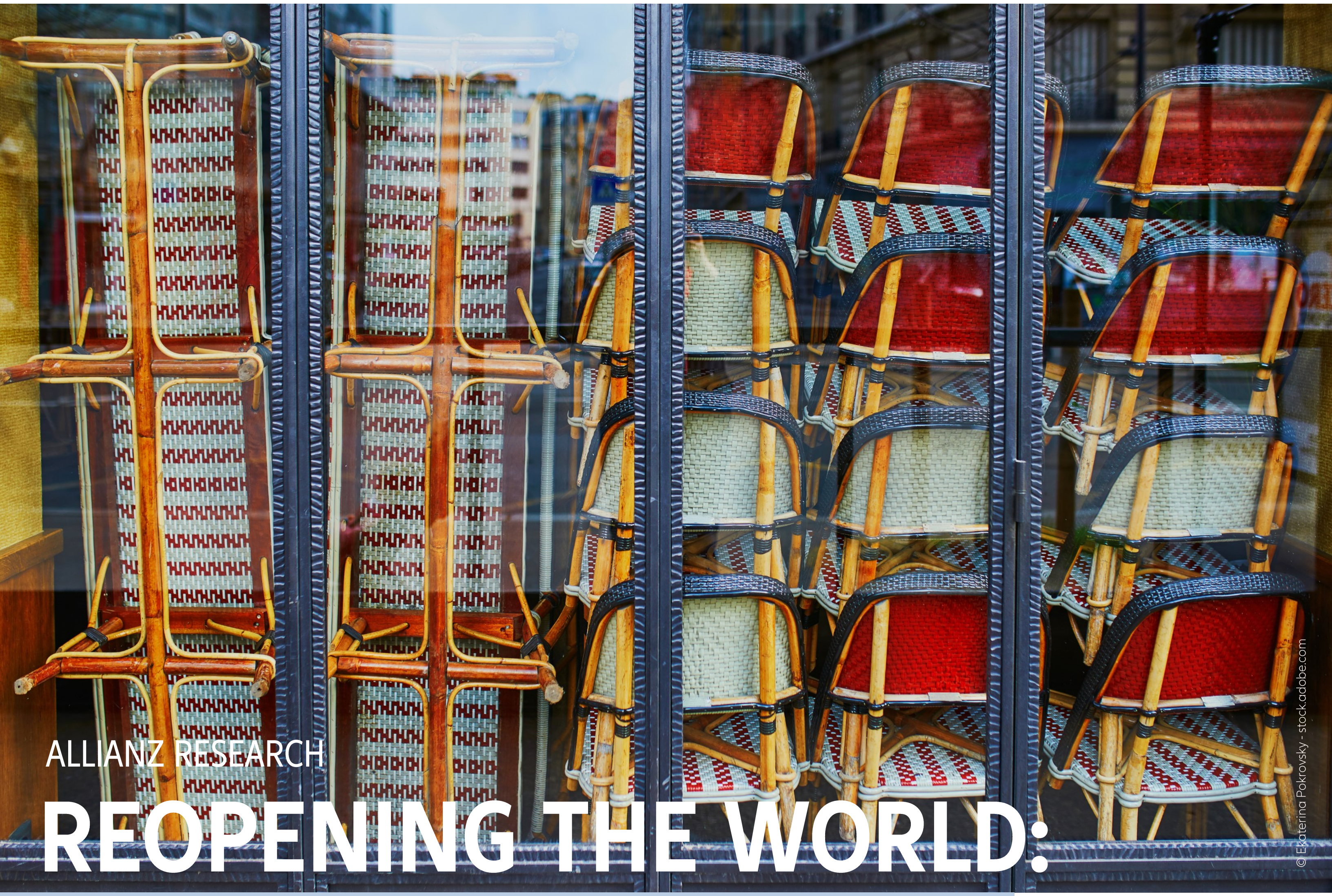

ALLIANZ RESEARCH

REOPENING THE WORLD: BEWARE OF FALSE STARTS

23 April 2020

EULER HERMES

Allianz

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- Black hole economics. Lockdowns for more than half of the global population and GDP have hit the world like a meteorite, pushing the global economy into its worst recession since WWII: -3.3% in 2020, equivalent to USD9tn lost or the GDP of Germany and Japan combined, and more than twice as bad as the 2009 Global Financial Crisis. Trade losses could total USD3.5tn in 2020. Insolvencies are set to increase by +20% in 2020. Up to one third of jobs are at risk of being lost without targeted protection schemes for longer.
- D-day in sight? Substantial excitement about a seemingly imminent exit from the coronavirus lockdowns is overrated. Managing the reproduction rate (R0) of the virus effectively will mean most economies will function at 70% to 80% of their potential for two-three quarters. Capital markets may thus get worse before they get better as realization kicks in. Also, watch the seven triggers for a protracted crisis instead of a U-shaped scenario.
- Adaptive policy toolbox urgently needed. Double-digit fiscal deficits, additional debt burden and ballooning central bank balance sheets (50% of GDP for both Fed and the ECB) helped mitigate the financial, economic and social costs of the crisis. Yet, now is the time to design policy for the solvency crisis ahead, and repair and recover. We designed a policy menu of options to tackle the economic stages of the Covid-19 crisis.
- Regional outlooks include the U.S. and Europe charting diverging pathways, China confirming a very partial rebound and Emerging Markets facing a perfect storm.

USD9trn

Expected global economic loss from the Covid-19 recession.

Figure 1: Global GDP growth forecasts

	2017	2018	2019	2020	2021
World GDP growth	**3.3**	**3.1**	**2.5**	**-3.3**	**5.6**
United States	2.4	2.9	2.3	-2.7	3.3
Latin America	**1.0**	**1.0**	**0.1**	**-4.1**	**3.7**
Brazil	1.3	1.3	1.1	-5.0	5.5
United Kingdom	1.8	1.3	1.4	-8.2	8.7
Eurozone members	**2.7**	**1.9**	**1.2**	**-9.3**	**9.3**
Germany	2.8	1.5	0.6	-8.9	8.7
France	2.4	1.7	1.3	-8.9	9.6
Italy	1.7	0.7	0.3	-11.4	11.0
Spain	2.9	2.4	2.0	-11.0	10.0
Russia	1.6	2.3	1.3	-2.5	5.2
Turkey	7.5	2.8	0.9	-3.3	7.6
Asia-Pacific	**5.2**	**4.7**	**4.3**	**-0.6**	**6.5**
China	6.9	6.7	6.1	1.8	8.5
Japan	2.2	0.3	0.7	-5.7	2.2
India	7.3	6.2	5.0	1.1	7.5
Middle East	**1.2**	**1.1**	**0.6**	**-4.5**	**2.4**
Saudi Arabia	-0.7	2.4	0.2	-2.0	2.0
Africa	**3.1**	**2.7**	**1.9**	**-1.6**	**3.6**
South Africa	1.4	0.8	0.3	-5.3	4.5

** Weights in global GDP at market price, 2019*

NB: fiscal year for India

Sources: Allianz Research , national sources

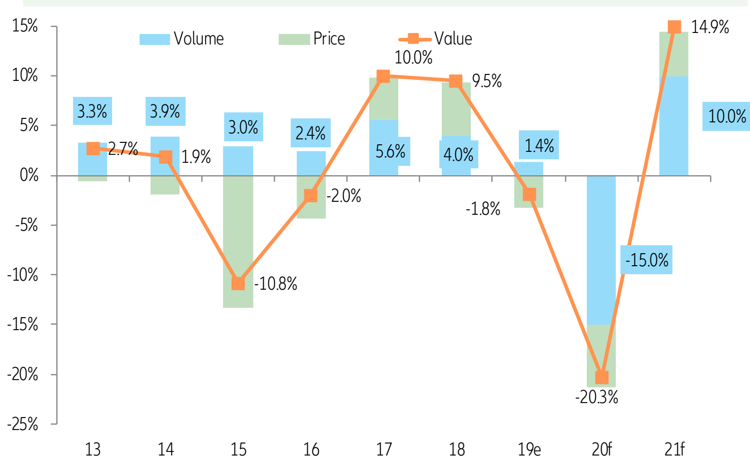
BLACK HOLE ECONOMICS: ESTIMATING A SHOCK OF UNPRECEDENTED PROPORTIONS

In [Quarantined Economics](), our last economic and capital markets outlook, we outlined the three shockwaves of Covid-19 on the economy, from trade to financial to lockdown. We also estimated the severity of the crisis (GDP, job losses, capital markets, insolvencies), taking into account the mitigating effect of the unprecedented policy response from central banks and treasuries around the world. Last, we envisaged two scenarios: a so-called U-shaped recovery (our baseline), and an L-shaped scenario (or protracted crisis) where the global economy would not get back on track within the next couple of years. The past month has confirmed our initial assessment and helped us fine-tune our analysis in at least three directions. First, several leading indicators helped us size the shock better. Secondly, we have more details about the health and economic arbitrages behind the reopening choices by countries. Last, it seems that much more has to come from policymakers to address the crisis. These are the three chapters we developed in this report.

Recent data suggests that domestic activity during the lockdown is around 30% below normal levels in most European countries that have implemented strict restrictions. Traffic congestion fell by 70% on average in the biggest European capitals, electricity consumption is down between 20% to 30% compared to mid-March while car sales have fell by 52% y/y in Europe and by 37% in the U.S. The consumption shock is very strong, as witnessed by the fall in retail sales: -24% m/m in France in March and -9% in the U.S.. The shock on business confidence is unprecedented in the services sector, where advanced indicators, such as PMIs, reached record low levels in April, while in the manufacturing sector the indicators went below the 2009 low. Employment prospects have deteriorated rapidly and the number of people benefiting from partial unemployment has increased rapidly: to above 10 million in France vs. more than 22 million people unemployed in the U.S. in one month. Consumer confidence across countries has posted another record drop. In the Eurozone, consumer confidence fell from -11.6 to -22.7 in March.

Full-fledged lockdowns have triggered an economic shock of unprecedented proportions. Taking into account the most recent progression of the pandemic and the decisions of different authorities, we now expect two months of lockdown on average for more than half of the global population and GDP, which has led to a significant downward revision of our global GDP scenario from +0.5% to -3.3% in 2020. The trough in activity is now expected to stand between -10% and -20% q/q in Q2 depending on the strictness of lockdowns across countries. This follows an already sharp recession in Q1 (from -2.5% to -8% q/q). Advanced economies would register a recession of -5.3% while Emerging Markets would be in a recession (-0.5%) for the first time in more than 10 years. Remember, this is the worst recession since WWII, equivalent to USD9tn lost or the GDP of Germany and Japan combined, and more than twice as bad as the 2009 Global Financial Crisis.

Figure 2: Global Trade growth in volume and value (%, y/y)



Sources: ITC, Allianz Research

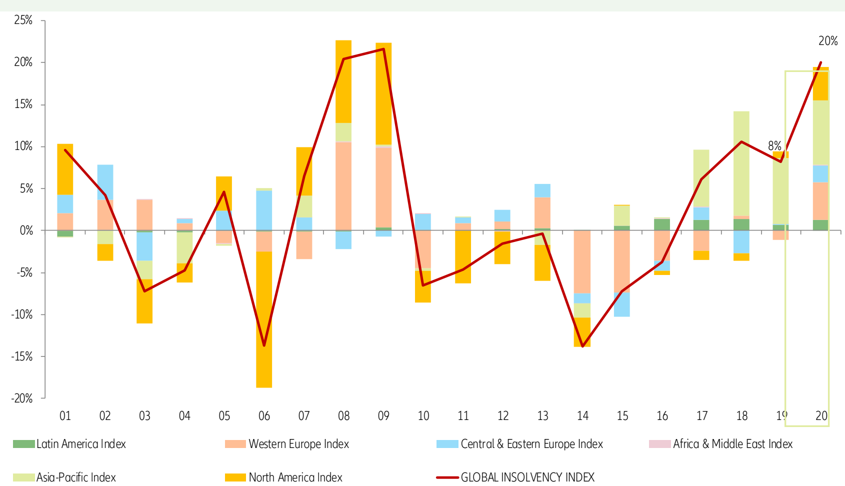
Trade losses could total USD3.5tn in 2020. We expect two quarters of recession in trade in goods and services (Q1 and Q2), which will bring the annual volume contraction to -15% in 2020. In value terms, plummeting commodity prices and a stronger USD will weigh on prices. We expect global trade in value to fall by -20%. This will push company turnover growth to -30% to -40% y/y in Q2 2020, notably in the Eurozone.

Protectionism will be a key feature of the life after Covid-19 and may jeopardize the recovery. We see increasing evidence of rising protectionism (note that export restrictions on masks could increase their prices by +20%), desire for industrial autonomy (Europe, France, U.S. for health and critical supply chains) and hidden subsidies (Japan's USD2.2bn stimulus plan to shift production out of China). In the short-term, export bans jeopardize the fight against the virus, especially in emerging and developing countries. In the medium-term, trade barriers signal a potential trend of shortening of supply chains, more investment protection and thus a costly (if happening) rebound.

Despite unprecedented support, insolvencies are set to increase by +20% in 2020. Looking at historical sensitivity to the economic cycle and government interventions to support corporates (tax deferrals, state loans and guarantees) and avoid top insolvencies and their domino effects, we expect global insolvencies to increase by at least +20% in 2020. This fourth consecutive year of rising insolvencies would result from a +25% increase in the U.S., a +15% rise in China and a +19% surge in Europe.

Up to one third of jobs are at risk of being lost. The U.S. job market is highly flexible. We estimate the unemployment rate to reach 9.4% on average in 2020. In the Eurozone, more than 70 million people are likely to benefit from partial unemployment schemes. Despite job protection in place, we expect a marked rise in unemployment in particular in countries where the scheme is limited to around six months such as Belgium, UK, Spain, Italy, France and Portugal. After all the very gradual economic reopening will put companies under pressure to reduce fixed costs, notably in those sectors that will see a relatively slower restart (hotels and accommodation, travel, retail). As a result, we estimate the Eurozone unemployment rate to rise by +2pp to 9.5% in 2020, with 18.5% in Spain, 11.8% in Italy, 10.5% in France and 6% in Germany. In the UK, we estimate the unemployment rate to rise from 3.8% to 8.5%.

Figure 3: Global and Regional Insolvency Indices (yearly changes in %)



Sources: Euler Hermes, Allianz Research

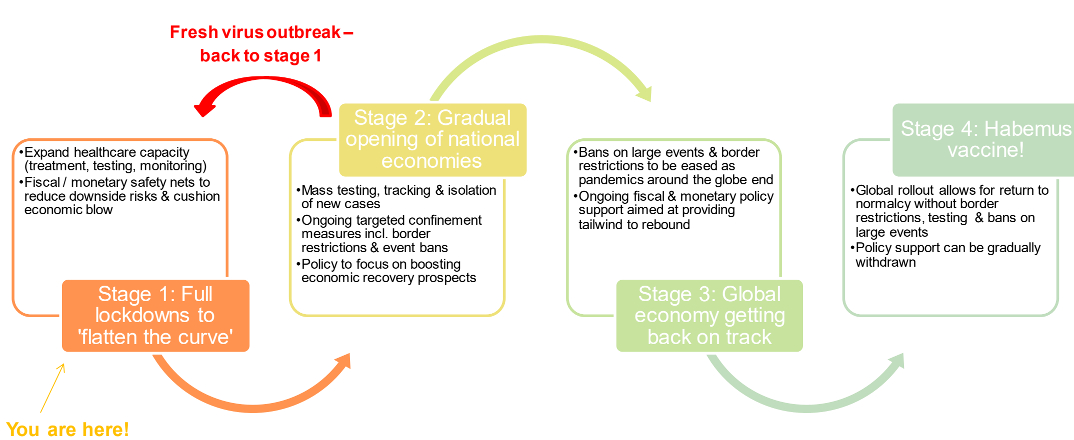
NO D-DAY IN SIGHT: MARKETS DID NOT GET THE PROGRESSIVE REOPENING MEMO

Substantial excitement about a seemingly imminent exit from the Covid-19 lockdowns is overrated. Major economies have announced plans for reopening but we expect de-confinement to proceed in a very gradual manner, which can be divided in four different stages: from full lockdown to gradual national reopening, to gradual international reopening and finally a full restart. What is important to understand is that managing the reproduction rate of the virus effectively (R0) will mean most economies will function at 70% to 80% of their potential for two-three quarters, with transport, travel, retail and hospitality on pause for longer. As a result, activity in the manufacturing and construction sectors may pick up faster than in services. Lessons learned from China show us that one month after the number of domestic Covid-19 infections dropped close to zero, production activities are still registering at 80%-85% of their usual pre-crisis levels, while consumer spending on durable goods remains at c.65% of normal levels. Globally, a return to business as usual is not on the table before mid-2021 (+5.6% GDP growth in 2021) and will be dependent on a vaccine being in place.

Caring, testing and monitoring capacities will be essential in reopening: Countries will not reopen in sync. We now look into three to four months of progressive de-confinement and the need to use circuit breakers between now and mid-2021 as new waves could come. To understand potential exit strategies and the risks associated with them, we grouped countries according to their health readiness to de-confine and their economic vulnerability to confinement. Our analysis reveals four clusters of countries at the time of writing. The first one, mostly made of Emerging Markets, is still unprepared to de-confine as the virus spread accelerates and health care facilities are struggling to keep up. A second cluster, the early birds, have ramped up testing and medical capacity (China, Denmark, South Korea) to de-confine fast. A third cluster comprises borderline countries (Italy, Germany, Singapore), where progress has been made but where countries remain economically vulnerable to longer and uncooperative confinement, often through their trade dependency. The last cluster still battles the epidemic (U.S., Japan, UK, France, Spain) and testing has not yet reached the standard of best performers, calling for de-confinement to be even more gradual and slow to avoid secondary outbreaks.

Markets: It can still get worse before it gets better. We still believe that the ground lost since February will not be fully recouped by year-end. To structurally calm down markets, there should be convincing evidence that the fiscal year is not completely lost and that the combination of an ever-decreasing contagion, paired with an effective restart of the economy, are taking place. Even if these two conditions are fulfilled, it is to be expected that investors fall shy of previous risk levels, hindering a complete V-shaped recovery from a momentum/sentiment perspective.

Figure 4: What it takes to get back to business as usual



Sources: Allianz Research

Figure 5: What it takes to get back to business as usual

Initial conditions

1. **Readiness**, from a health sector and virus spread perspective. This includes the virus spread momentum, medical capacity, testing capacity, the use of technology tracing early on.
2. **Economic vulnerability** to prolonged confinement: GDP and employment structure (services, industry…), growth momentum, % of tourism in GDP, reliance on foreign labor, density of population in cities, political pressure, informality

Deconfinement strategy

1. **Length** and timeline of deconfinement
2. **Geographic segmentation** (intra/interregional mobility)
3. **Restrictions on movements** (borders, trade, gatherings and demographic segmentation)
4. **Sector segmentation**: which shops open, industries restart, schools open
5. **Health response**: health protocols in the private and public sector, testing strategy

Impacts on the economy

1. **Shape of the recovery**: U-shape, L-shape, jump function (S-shaped)
2. **Time to reach pre-crisis activity** level and/or pre-crisis pace of growth
3. **Workforce impact**: unemployment increase, labor shortages in specific sectors
4. **Inflation impact**, especially in specific sectors
5. **"Paused" sectors vs. structurally damaged** ones (insolvencies)

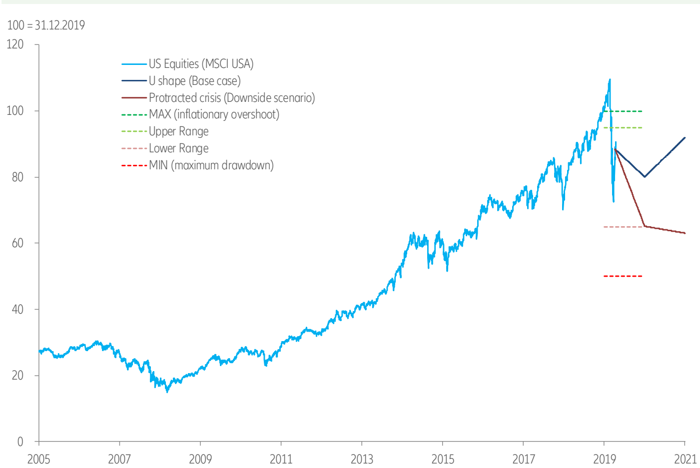
Sources: /Allianz Research

Even after the recent equity recovery, we remain convinced that it is still complicated to impose a fundamental-based recovery trajectory. At this point in time and consistent with our valuation approach, we continue to expect U.S. equity markets to post a -20% yearly performance for 2020 and to gradually start recovering to previous levels (although not managing to reach previous peaks) within 2021. Similarly, we expect European equity markets to follow the exact same path but with a -22% performance for 2020.

At this point in time, we continue to expect U.S. long-term bond yields to finish 2020 at around 1.0%. Global long-term sovereign markets have calmed down after several weeks of erratic behavior. The mix of bad and good news both from a pandemic and fiscal and monetary perspective has led markets to a perpetual hunt for their anchor or fundamental forward-looking value, which they seem to have now found. Beyond 2020, we expect long-term U.S. yields to converge to pre Covid-19 fair-value levels (1.4%) by the end of 2021. Similarly, 10y Bund yields are expected to remain trading around -0.5%. Mirroring the U.S., we expect long-term German yields to converge towards -0.3% by the end of 2021.

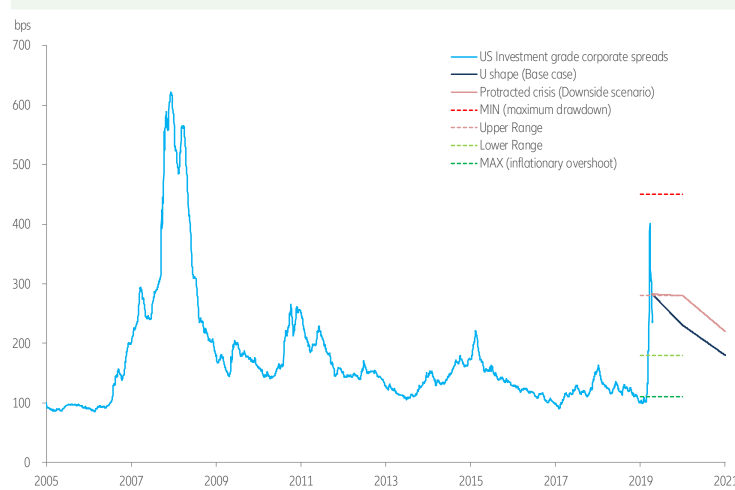
Global corporate credit remains one of the most affected asset classes during this recent period of extreme volatility. Within the asset class, certain sectors remain under pressure. Travel & leisure, air transportation and oil & gas are seen as the specific sectors that carry the most embedded risk, both within the investment grade and the high-yield universe. From a scenario perspective, we still expect investment grade corporate spreads to experience a mild structural widening towards year-end, leading spreads to higher levels than the ones seen at beginning of the year (230bps for the U.S. and 180bps for EUR denominated corporate debt). Looking at 2021, we still expect corporate credit spreads to slowly but steadily start readjusting to previous historical lows (150bps for EUR Credit and 180bps for U.S. Credit).

Figure 6: U.S. equities outlook



Sources: Refinitiv, Allianz Research

Figure 7: U.S. investment grade spreads



Sources: Refinitiv, Allianz Research

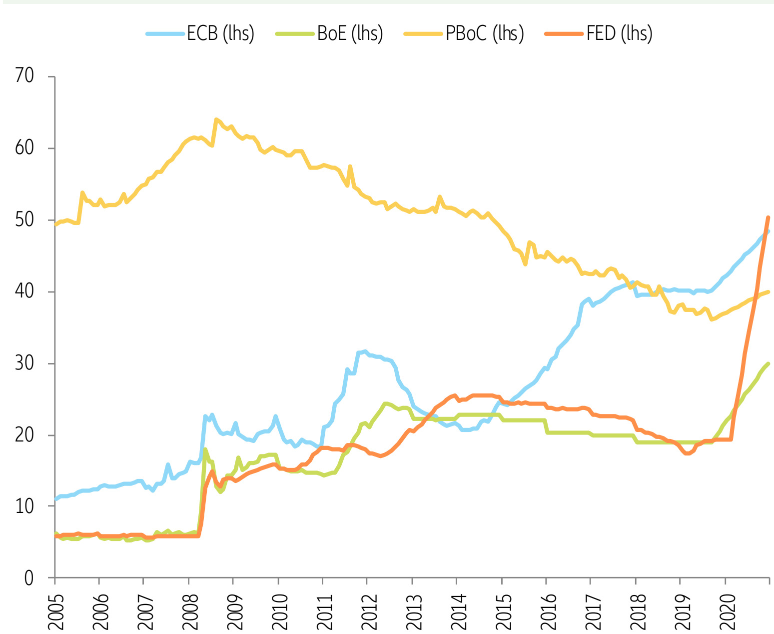
What could go wrong: Seven possible sins. In [Quarantined Economics](), we warned about three types of risks that could cause an L-shaped scenario: (i) rerating wave of corporate bonds; (ii) risk of a liquidity crisis and (iii) the difficulty to restart the world and tail risk of policy mistakes. There are other seven risks that need to be watched: (1) A second (more severe) outbreak of the virus, which would keep the global economy below pre-crisis levels until the end of 2021. (2) Long-lasting uncertainty and low confidence delaying investment and boosting precautionary savings. (3) Policy mistakes – insufficient support from central banks – and the lack of adequate fiscal burden-sharing in the Eurozone to trigger a relapse and a sovereign debt crisis. (4) A banking or real estate crisis that could be a side-effect of a violent surge in high-risk lending, and non-payment from cash-strained companies. (5) Unaddressed rising inequalities resulting in higher social discontent and political tensions, notably in Emerging Markets. (6) Shorter supply chains driving protectionist measures across the world and feeding into structurally lower corporate margins. (7) Excess moral hazard createing a collective risk of more inflation (if central banks go overboard with monetization), debt restructuring and increased taxes. To avoid a protracted crisis liquidity is a must (debt and cash; markets, banks, and companies), and confidence in institutions is paramount.

Figure 8: Fiscal deficit and public debt ratios, 2020-21 by country

	Fiscal relief announced (local currency)		Impact on GDP growth (in pp)	Fiscal deficit		Public debt		Expected fiscal relief in the second phase	Expected recovery fiscal stimulus package
		(% of GDP)		2020	2021	2020	2021	(% of GDP)	(% of GDP)
Germany	123	3.6%	1.3	-7.0	-3.0	72	68	2.0%	2.0%
France	110	4.7%	1.9	-11.0	-8.0	118	116	0.5%	2.0%
Italy	25	1.4%	0.7	-13.6	-3.7	169	156	1.0%	1.0%
Spain	23	1.8%	0.5	-7.8	-4.5	116	110	1.0%	1.5%
UK	65	2.9%	1.2	-7.4	-4.8	93	96	1.5%	2.0%
US	2300	10.8%	2.2	-12.0	-10.0	90	96		10.0%

Source: Allianz Research

Figure 9: Central banks' balance sheets (% of GDP)



Source: Official sources, Allianz Research

UNPRECEDENTED POLICIES WERE NEEDED BUT MORE MUST COME TO SECURE A U-SHAPED RECOVERY

Double-digit fiscal deficits and ballooning central bank balance sheets (50% of GDP for both Fed and the ECB) helped mitigate the financial, economic and social costs of the crisis. In France, more than 10 million people are in partial unemployment while in Germany 725,000 companies are using Kurzarbeit. In total, the cost of saving jobs looks set to exceed 1.5% of GDP in each country. In addition, more than EUR1trn of public guarantees will push public debt to new record levels: 169% of GDP in Italy, 118% in France. Debt sustainability concerns could rise in the medium-run and financial markets will be looking for effective fiscal stimulus during the recovery phase on top of support to consumer purchasing power: infrastructure spending (including green investments), tax incentives for boosting domestic investments along with corporate tax reforms and easy financing for SMEs. We expect 1.5% to 2% of GDP of fiscal stimulus measures during the recovery phase in Europe and close to 10% in the U.S.

The Fed is already the Hulk[1]. What to expect next. In its current configuration, the size of the Fed's balance sheet has swollen from USD4.13 trillion to USD6.34 trillion year to date. We expect this pace of growth of USD2 trillion to last for one month more (in April), then the pace could be halved for the first month of the phase two of de-confinement (corresponding to our level two of economic policy, in May) and then be halved during the three following months (June, July, August). During the phase three of de-confinement (our level three of economic policy stage, from September to December), we then could see a further halving of this pace of growth with an additional USD 250 bn per month. At the end of the year, the total size of the Fed's balance sheet could reach USD11.5trn, close to 50% of GDP. In the meantime, the composition of the Fed's balance sheet will evolve. Securities held outright now represent 80% of total assets. We expect this share to progressively decline in favor of lending facilities targeting states, businesses and cities. From the beginning of 2021 onward, we could have a plateauing in the size of the Fed's balance sheet, with this size remaining constant in order to be able to absorb the important volume of new issuance in U.S. public debt. A first initiative of normalization could take place at the end of 2021- beginning of 2022 with two rate hikes of the Fed Funds Target rate.

The ECB: Saving the day – every day. The ECB went big and comprehensive (liquidity provision to banks, a new Pandemic Emergency Purchase Program PEPP), increasing total monthly asset purchases to around EUR115bn until end-2020, and temporary suspending issuer limits.

[1] Unlimited purchases of Treasury and mortgage-backed securities – they had previously been limited to USD500bn and USD200bn respectively; Provision of USD300bn more in new financing to employers, consumers and businesses via a new program to be defined and capitalized by the U.S. Treasury, with USD30bn coming from the ESF (Exchange Stabilization Fund); Creation of two new facilities to support credit to large employers: the PMCCF (Primary Market Corporate Credit Facility), for new bond and loan issuance, and the SMCCF (Secondary Market Corporate Credit) to provide liquidity. Only investment grade companies will be eligible. They will be able to benefit from a four-year financing bridge; Resurrection of the TALF (Term Asset-Backed Securities Loan Facility) to encourage the issuance of ABS (Asset-Backed Securities) backed by student loans, auto loans, credit card loans and loans guaranteed by the Small Business Administration; Municipal bonds with variable rates and banks' certificates of deposit to eligible for the MMLF (Money Market Mutual Fund Liquidity Facility); Extension the securities being targeted by CPFF (Commercial Paper Funding Facility); Creation of a Main Street Business Lending Program to support lending to small and medium-sized businesses representing USS 2,3 trillion. It will offer loans on business with up to 10,000 employees and revenues of $2.5 billion. The total amount available will be $600 billion. It also included $500 billion in loans directly to states and municipalities (not just buying their bonds). It also expanded recently created lending programs by $850 billion

Still, the ECB could well be forced soon to pull another trick out of its hat in an effort to impress markets and calm growing debt sustainability concerns, given the persisting political disaccord on fiscal burden sharing[2]. PEPP will be continued in 2021 as the ECB is now engaging in a European form of yield curve targeting to "to close the spread". This will require at a minimum that the average monthly pace of asset purchases of close to EUR100bn will have to be maintained in 2021 at an average monthly pace of EUR75bn and that the APP continues at the current monthly pace of EUR20bn. In practice this will mean expanding the ECB balance sheet by a further cool EUR1 trillion also in 2021 as debt issuance will remain significant in 2021. Given that the ECB has frontloaded its PEPP purchases, an announcement of a PEPP extension in terms of size and duration could already come as early as Q3 2020 in an effort to confirm its commitment and to drown out any potential concerns. Even though the Eurozone economy looks set to recover to pre-crisis levels in H1 2021, we believe that monetary policy will continue to stimulate the Eurozone economy throughout 2023. The monthly pace of asset purchases should be reduced from close to EUR100bn to about EUR20bn in 2023, but low rates and extensive banking support will still be necessary, given the legacy of the Covid-19 crisis, including elevated debt levels in the public and private sector and lingering NPLs on banks' balance sheets.

Reopening one policy step at a time: As of now, policies should shift from emergency liquidity support to solvency support, with targeted and increasingly conditional measures to avoid further zombification of the economy. We have compiled main fiscal and monetary policy measures by target (household, businesses and financial sector) and by stages. The Covid-19 crisis creates an unprecedented savings glut: We expect saving rates in Europe to remain +6pp above pre-crisis levels at 21% at end-2020). During de-confinement, we would expect governments to implement more consumer-oriented policies (VAT tax cuts, adaptive social protection, vouchers) to boost consumption and avoid sparking off social discontent. At the same time, they would maintain fiscal relief measures to the hardest hit sectors: air transport, hotels and accommodation and retail, and support companies that start to export again. To avoid increased household precautionary savings, stronger social protection, clear incentives to consume and invest and measures to unleash entrepreneurship and shareholding should be favored.

Then as the world starts reconnects, policies should plant the seeds of the recovery, including for the international web. This critical phase is conditional on the success of national de-confinement strategies; new cases need to be tested, traced and isolated quickly so that the scenario of a second outbreak becomes less probable. The focus here shifts from fiscal relief to fiscal stimulus, the impulse needed to trigger a new investment cycle on the back of declining saving rates and a lower fear factor. The focus needs to be on active labor policies to incentivize employment growth. As global demand restarts, incentivizing investment through accelerated amortization and targeted lending, and boosting trade finance, could also be catalysts for the recovery.

Last, policies will have to tackle the crisis legacy and avoid a relapse. The sudden release of economic engines with the re-opening of activity and resolution of bottleneck effects mean economies rapidly converge toward their potential to eventually overshoot it during the rest of the year. Preparing for the future in stage four means investing in public health and infrastructure, scaling up the green stimulus and innovation policy, investing in local production capacity for key medical equipment and re-thinking the role of governments and central banks in the economy.

[2] Compared to the new debt to be issued in the coming months by Eurozone governments – and in particular by Italy, where we expect the debt burden to rise close to 170% of GDP this year – the ECB's EUR750bn Pandemic Emergency Purchase Program is starting to look decidedly less mighty. The four largest economies alone – Germany, France, Italy and Spain – look set to issue about EUR1trillion in long-term debt in 2020. Smaller policy tweaks such as reinvesting PEPP purchases or accepting junk-rated bonds as collateral are likely but will certainly prove insufficient on their own in this context.

Figure 10: Policy support by stages of the Covid-19 crisis

		Stage 1: national lockdowns *(Peak of the sanitary crisis, Q1-Q2 2020, insufficent testing capacities for many countries)*	Stage 2: national deconfinement *Post peak of the sanitary crisis, reproduction rate below 1, Q2-Q3 2020, building up on testing capacities, and contact tracing where available*	Stage 3: international opening and Stage 4: return to normal *From Q3-Q4 2020 for stage 3, Q1-Q2 2021 for stage 4, full testing capacity followed by vaccine made available*
		Whatever it takes, or the Lifeline stimulus : generalized (supply and demand) and unconditional liquidity support	Targeted incentive-based stimulus: conditional and more parcimonial, targeting solvency	Stimulus focused on economic structure: supply-chain and trade or tourism stimulus Long-term investment stimulus: phasing out short-term stimulus, preparing for the future
Monetary policy	Households	Indirect help to households via purchase of government bonds and mortgage backed securities, purchases of Asset-Backed Securities backed by student loans, auto loans, credit card loans (Fed)	Indirect help to households through unemployment benefits via purchase of municipal bonds (Fed)	Easing of mortgage and consumer credit conditions (China, 2016)
	Businesses	Purchase of corporate bonds, commercial paper Direct credit provisions by central bank, purchase of securities issued by fallen angels (in terms of rating) (Fed) Low rates and banking sector liquidity operations indirectly support lending to the private sector.	Purchase of commercial paper and bonds Direct credit provisions by central bank, purchase of securities issued by fallen angels Low rates and banking sector liquidity operations indirectly support lending to the private sector.	Gradual slowdown in net asset purchase pace Re-calibration of reinvestment policies Unwinding of central bank balance sheets (longer horizon: 2022-2023 for the Fed, ECB even later) Low rates and banking sector liquidity operations indirectly support lending to the private sector.
	Public sector	Purchase of sovereign bonds (Fed, ECB, BoJ, ...) Ensuring favorable refinancing conditions for sovereigns via puchases of sovereign assets: implicit yield curve tageting)	Purchase of sovereign bonds (Fed, ECB, BoJ, ...) Ensuring favorable refinancing conditions for sovereigns (via puchases of sovereign assets: implicit yield curve tageting)	
	Financial sector	Liquidity provision for financial intermediaries: via lower rates and looser collateral requirements (ECB) Encouraging bank lending through lower reserve requirements on bank lending to households and SMEs; deregulation of lending to SMEs, and temporary easing of solvency rules, bank provisioning needs and of bank loan classification rules Actions to preserve market liquidity Larger central bank swap lines with EM central banks (Fed, PBoC)	Liquidity provision for financial intermediaries: via lower rates and looser collateral requirements (ECB) Equity injections (BoJ) Larger central bank swap lines with EM central banks (Fed, PBoC) Continue encouraging SME lending (see stage 1) notably through lower reserve requirements	Liquidity provision for financial intermediaries: via lower rates and looser collateral requirements (ECB) Targeted lending for specific industries and company types (private sector, SMEs), structural reforms to improve efficiency of monetary policy transmission (China) Re-align financial regulation in a new framework (Basel V)
Fiscal policy	Households	Expand scope of social benefits and extend right for the duration of the crisis: unemployment insurance extended to gig workers, more flexible temporary unemployment (compensation of furloughed employees), increased and extended sick leave reimbursements, Complement welfare state or substitute for lack thereof with cash transfers to the most vulnerable Suspension of mortgage payments, student loans Tax or social security contributions deferrals Bonuses for healthcare personnel Targeted programs for informal economy workers: vouchers and cash transfers	Continuation of compensation of furloughed employees / other safety net Cash transfers to reboot consumption for the more vulnerable Unlocking benefits or pensions in advance to frontload consumption Easing of special sales restrictions	Improving redistribution policies addressing inequalities For people having lost low-paid jobs that may not be recovered, a permanent minimum income benefit might be needed Active labor policies to incentivize employment post-crisis Vouchers to target specific sectors and support directly consumption: cultural and food vouchers for instance Consumption tax cuts (stage 3) Salary increases for essential workers (health, retail, transport) Easing of purchase rules in the housing sector (China in 2016, not in the radar for this round of stimulus at the moment)
	Businesses	Wage supplementation: compensation of furloughed employees Cost compensation: - Postponement of taxes on companies and self-employed - Cancellation of late fees for State and local authorities procurement contracts - Postpone water, gas or electricity bills and rents during lockdowns - Cancel rents for companies and grant tax credits to landlords at the end of the fiscal year Equity participation: Temporary stakes/increases in state-ownership for some firms facing exceptional difficulties Cash transfer: Direct cash advances for companies not eligible for state guaranteed loans Enhanced means to tackle emergency: Rapid disbursement of funds through digital financial platforms (e.g. for emergency loans) Joint actions between national and regional authorities to manage the crisis: with help of regional public banks	Continuation of lifeline stimulus for still impacted/strategic sectors: could be credit lines providing liquidity support to tourism sector delayed tax collection for the tourism + transportation, cancellation of employer's social contributions. Direct subsidies based on past sales (tax based) Trade finance, liquidity provisions for exports ; Cutting import tariffs on covid-19 related products Continue simplification / temporarily suspend the application of some standards/regulation: access to support from government, insolvency prodcedure Gradual overturn of exceptional temporary unemployment conditions while disincentivizing layoffs Equity participation: Temporary stakes/increases in state-ownership for some firms facing exceptional difficulties Relaunch trade and distribution activities because there will be no massive restart of the industrial sector without outlets. Extension of opening hours in food and other stores to avoid crowds	Cutting import tariffs to alleviate pressure on importing companies, amid already strained supply chains Bilateral and multilateral debt write-offs for emerging and developing countries Green stimulus: carbon price, carbon tax, green car scrap page scheme Investment plans: in public health (Boost support to WHO), research and development, supporting investment in digital transformation of companies, infrastructure projects Identifying and protecting strategic sectors/industries: for instance, re-stocking of key medical supplies and protective equipments, investing in local production capacity Investment incentives: accelerate amortization of capital, reduction national production taxes Introduction of a stability mechanism for over-indebted municipalities to prevent them from becoming a bottleneck in the transmission of stimulus (investment projects, social benefits) => important for federal countries
	Financial sector	Limit some financial transactions (shorting equity markets) or the use of state funds to companies for share buybacks State guarantee mechanism for new liquidity loans granted by credit institutions	Use or create state funds (high quality issuers leveraging on top rating) for debt-equity-swap schemes or alternative financing (mezzanine, convertible bonds) for companies, rescue fund for over-indebted regional governments and municipalities (avoid bottleneck in channeling money to households and companies) Coordination with credit insurers and re-insurers, further supporting banks distributing loans to SMEs (purchase of loans) Measures focused on financial sector: bail-in/out, recapitalization or nationalization	Debt write-offs; bail-in/out, recapitalization or nationalization

Source: Allianz Research

REGIONAL OUTLOOKS

In **the U.S.**, a rather short duration of the lockdown and bazooka policies will limit the impact of the Covid-19 shock. We expect more fiscal stimulus to be announced before year-end in favor of the corporate sector and municipalities, while the announced USD2tn for infrastructure spending program is less certain. The Covid-19 shock was immediately visible in job market conditions: initial unemployment claims jumped to a historical high of 22 million people in the two last weeks of March and two first weeks of April, which is likely to elevate the unemployment rate from 4.4% to 13.5% before year-end. In terms of growth, this kind of adjustment would mirror a significant decline of growth from +2.5% y/y in Q4 2019 to a trough of -8.6% y/y in Q2 2020 (-30 q/q annualized). In these circumstances, U.S. GDP growth would contract by -2.7% y/y in 2020 compared with its growth of +2.3% y/y in 2019. This represents a significant downward correction compared with our prior scenario for 2020 of +0.5% y/y. Our sensitivity analysis had already identified the fact that switching from a one-month to a two-month confinement (social distancing in the U.S.) was enough to anticipate a much lower level of growth (close to -2% y/y). We now anticipate two months of social distancing and a delayed de-confinement, meaning that the U.S. would return to its "normal" level of activity prior to the Covid-19 crisis only in the middle of Q4 2020 or beginning of 2021. This scenario is likely to translate into a significant rise in the delinquency rate of industrial and industrial loans to 6.5% at the end of the year, compared with 1.1% before the crisis. This is equivalent to an expected increase of insolvencies by 25% y/y, compared with 7% in our previous estimate. Amid mounting economic difficulties, the U.S. government announced a rapid extension of the PPP (Paycheck Protection Program) program, which was quicklyexhausted, with an additional USD484bn to be soon voted on by the Congress. We expect further stimulus to complete the so-called CARES program (Coronavirus Aid, Relief, and Economic Security) Act (USD 2.3 trillion) and be announced in the coming weeks, in particular in the direction of states and big municipalities. A big infrastructure stimulus, amounting to USD2trn could be announced later, albeit with a certain delay and lower probability as bi-partisanship is less established in this area (we don't integrate it in our scenario for now). We estimate at USD500bn the supplementary mattress of stimulus policy to be announced before year-end and prior to a potential infrastructure program.

The **Eurozone** economy will take a year to recover to pre-crisis levels. The domestic shock accounts for 30% to 40% in countries where confinement is very strict such as Spain, Italy, France and the UK. A two-month confinement period, coupled with a very gradual easing of containment measures, will push the European economy into the sharpest recession since WW II. We expect GDP growth to contract very strongly in H1 2020 (-4% q/q to -8% q/q in Q1, and from -10% to -20% q/q in Q2 depending on the country). The gradual easing of containment measures in several countries from early May onwards will set the stage for a marked – albeit to a large extent technical – GDP rebound in H2 2020. Already announced deconfinement plans suggest that controlling measures (mandatory face masks in supermarkets and public transport, a prolonged ban on events till at least end-June and targeted containment, consisting of isolating infected persons, testing suspected cases and tracking infections) will remain in place for several months to minimize the risk of a renewed surge in infections (see Exiting the lockdowns – A tale of four stories). Moreover, deconfinement at first will largely concern the domestic economy. As a result, we expect the EU single market to remain impaired by border restrictions until early 2021. Meanwhile, external EU border restrictions – in particular against countries that are less capable of containing the virus outbreak or that are pursuing a herd immunity strategy – could well remain in place throughout 2021 until a vaccine will be in place. Therefore, it should take until early 2021 – i.e. a full year - for Eurozone GDP to recover to its pre-Covid-19 levels. However, in some countries, particularly those that boast a large value-added share in services and tourism, the recovery process could well last until mid-2021 as these sectors may see longer-lasting damage from the crisis. Despite more stimulus expected down the line in an effort to jump-start the economic recovery, European countries look set to contract by close to -9% (France, Germany, the UK) to more than -10% in 2020 (Italy, Spain). We anticipate additional fiscal support during the crisis exit period: from infrastructure spending to electric car scrappage schemes and corporate investment incentives. We estimate that a doubling of current support packages from 2% of GDP could lift GDP growth by 1ppts. The dynamic rebound in 2021 of +8.7% is based on the assumption that a vaccine or an effective treatment is in place that allows for a return to normalcy.

In **China**, our 2020 GDP growth forecast now stands at +1.8%, revised down from +4.0% (after +6.1% in 2019). We have factored in the impact of the latest Covid-19 news domestically and in the rest of the world: the risk of second waves of outbreaks in China is delaying activity resumption and domestic demand, and confinement measures in place in China's trading partners is pressuring external demand. High frequency data indeed suggests that production is still 15%-20% below its usual level (even lower for consumption), meaning that resumption is slower than we had expected in early March. We now account for a full resumption of economic activity in June 2020. The recovery of the Chinese economy should become more visible in H2, helped by an accommodative policy stance, particularly on the fiscal side. We expect supportive fiscal measures to account for 6.5% of GDP in total in 2020, after 3.3% last year. Fiscal stimulus is mostly composed of public investment (in infrastructure, health, green policies, technology and other projects) and corporate tax and fees cuts. On the monetary side, the PBOC has injected 2.8% of nominal GDP worth of liquidity, with a particular focus for SMEs. We expect further injections worth at least 1% of GDP. Credit conditions should also be eased further, with the loan prime rate lowered by a further 20bp (after 20bp since the beginning of the year).

The worst is not over in the emerging world. Economic activity in the **Emerging Markets** has also been choked off by internal and external confinement measures, along with disruptions to supply chains and the dramatic decline in global trade volumes in general. We have therefore slashed our forecasts and now expect EM GDP to contract by -0.1% in 2020. This would be the worst output decline rate since comparable statistics became available, including during the 2008-2009 Global Financial Crisis (+0.8% for EM). In our baseline scenario, we assume two months of full confinement on average in major EMs, followed by a gradual lifting of restrictions and a return to pre-Covid-19 output only in early 2021. We forecast a rebound to +5.9% growth in 2021. However, risks associated with the global shock are skewed firmly on the downside. Crucially, EMs have mostly limited and unequal capabilities to fight this pandemic. The lower their capabilities, the longer confinement could last: we find Nigeria, South Africa, Ukraine, Argentina, Romania and India as the most vulnerable. Moreover, EMs have registered record capital outflows since March, triggering very strong currency depreciations and liquidity constraints for the weakest. Should the liquidity crisis turn into a debt crisis, the large EMs most at risk of rating downgrades and subsequent sovereign or corporate defaults are Argentina, Turkey, South Africa, Angola, Mexico, Chile, Ecuador, Pakistan, Indonesia, Malaysia, Romania and Hungary.

In **Asia-Pacific**, we now expect aggregate growth to decline to -0.6% in 2020. This means that the Covid-19 shock would be larger than the Asian financial crisis (1998 growth at +0.1%). All of the main economies of the region should experience a technical recession in H1 (except for China and India) as confinement measures are being announced and/or extended. Economies seeing (renewed) outbreaks of Covid-19 and more dependent on global trade and tourism are likely to be hit the hardest, including Hong Kong, Singapore, Thailand, Malaysia and Japan. We have also significantly downgraded again our forecasts for Australia and New Zealand, as the countries enter their winter months and confinement measures may not be lifted quickly despite promising downward trends in infections recently. Going into 2021, we expect a recovery in Asia-Pacific, with GDP growth improving to +6.5%. In a downside scenario of a protracted global crisis, GDP growth for the Asia-Pacific region could decline to -9.8% in 2020 and -0.1% in 2021.

In **Eastern Europe**, annual GDP is forecast to contract by -3.9% in 2020, followed by a rebound to +6.2% in 2021. Open and tourism-dependent economies will be hardest hit by the Covid-19 crisis (e.g. Czechia, Slovakia, Croatia). Romania, Russia and Turkey have relatively weak health systems, potentially requiring longer confinement. Russia (-2.5% in 2020) also faces the sharp drop in oil prices, but is currently pumping more oil than in 2019 (which paradoxically mitigates the decline in GDP growth) and has sufficient fiscal power to withstand the shock for at least a year. Turkey's growth is forecast at -3.3% in 2020 as it benefits from a good start to the year, but risks are skewed more to the downside than for others, notably because non-financial corporations have large external debt payments falling due in the next 12 months, which is likely to result in payment defaults.

In **Latin America**, recession is unavoidable and is likely to be the strongest on record, due to a triple shock. The China trade and commodity price shock, the oil price shock and lastly the stronger shock of confinement measures on virtually all economies. Overall, we expect a contraction of around -4.1% in 2020 in our baseline U-shaped scenario, and -8% in case of a protracted crisis. Monetary policy easing will help cushion the blow but won't prevent recession from happening. Few countries have fiscal leeway (Chile, Peru, Mexico to a lesser extent) so many will have to resort to emergency IMF lending. The countries most at risk are oil exporters, tourist destinations and lower-income Central American countries. The risk of policy mistakes is high in Mexico and Brazil, where political pressure and labor informality render confinement difficult.

The **Middle East** is facing the twin shock of Covid-19 and the sharp drop in oil prices. As a result, real GDP in the region as a whole is forecast to contract by -5.1% in 2020 in our baseline scenario, before moderately recovering to +2.2% growth in 2021. In our downside protracted crisis scenario, output would plunge by -11.6% in 2020 and fall by another -1.3% in 2021.

Africa has been hit by the Covid-19 outbreak mainly through the sharp decline in commodity prices (oil, cacao, metals and minerals) and the slowdown of trade with China and Europe. The economies, which would be hit the hardest by the decline in oil prices are Nigeria, South Africa, Angola, Gabon, Ghana and Congo. The disruption of tourism activity and the drop in remittances could put the external sector under pressure in Egypt, Tunisia, Morocco and Ethiopia. The region is expected to enter recession in 2020 (-1.6%) and rebound slightly in 2021 (+3.6%).

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