In the Air Tonight… Still

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A **significant upswing in virus cases** in Europe, the U.S., and Canada, as well as associated new restrictions in many jurisdictions, rumbled loudly in the background this week. Also weighing on sentiment were some **setbacks on the vaccine front** and the dawning realization that the **stimulus cavalry** is, in fact, **not riding to the rescue** before the U.S. election. Yet, amid all the bad news on the building second wave—and there's a lot of it—was an underlying drumbeat of **better news on the global economy**. It can be easy to miss, because the starting point for activity was so awful after the early-year shutdowns. But the recovery has been consistently better than generally expected for most major economies, and that remains the case… at least up to this point.

Financial markets haven't missed the economic message; in fact, they presaged the comeback with the spirited recovery in the spring. And while there were some wobbles this week on the factors noted above, the fact is that **equities** are almost back at record highs, **commodity prices** are hanging in there, and **bond yields** are stuck in a narrow range. All of this amid a disconcertingly rapid run-up in case counts in recent weeks, and the obvious risks to the recovery. Some of the market resilience is owing to evidence that the economic backdrop has improved more than expected. Here are some examples that emerged this week:

- **Global Economy:** The IMF released its latest semi-annual outlook this week, and in its words, the situation is *"less dire"* than its June review. To be fair, it would be tough to be more negative than the IMF was around mid-year. Still, the upgrades to global growth and most major economies are welcome amid renewed virus concerns. Overall, it bumped the estimate for 2020 by almost a percentage point to a drop of 4.4% (from -5.2%), which is still south of our call (-4.0%). And next year it looks for a hearty 5.2% rebound (we're at +5.5%). One caveat on the upgraded IMF outlook is that emerging markets outside of China, notably India, have been marked down. That reflects a tough experience with the virus, and a heavy reliance on tourism or remittance receipts.

- **China** may have been the first to grapple with COVID, but it's also been the first to recover. September trade data reveal that the economy has more-than-recouped earlier losses, with exports vaulting almost 10% y/y and imports kicking into gear as spending finally revives. A solid 7% y/y gain in auto sales last month confirms the latter. Next week brings the first peek at Q3 GDP, and it should be solid (a bit above +5% y/y). Bluntly, the shift in global spending from services to goods, and the specific goods that people are buying, have proven to be a big win for China's factories. Note that the yuan has moved through 6.7/US$, its strongest level in more than two years and up 5% y/y.

- **U.S**. consumers are still spending even in the face of rising virus cases (again) and a lack of new stimulus. September retail sales handily topped expectations with a

1.9% m/m jump, and are now up more than 5% from a year ago. For all of Q3, sales roared ahead at a 66% annualized pace. The firm activity even late in the quarter pretty much runs precisely counter to what many were expecting, given the drying up of extra unemployment benefits. But, as we opined last week, households overall can deal with a (temporary) lull in income support until after the election, thanks to the massive savings buffer built up earlier this year. This is not to downplay the clear signs of a more recent broad cooldown, as highlighted by a rise in initial jobless claims. However, note that small business sentiment rose to a pandemic high last month and the Philly Fed manufacturing index jumped in early October, suggesting activity is still grinding forward.

- **Japan:** After lagging the rest of the world on the growth tables for decades, Japan is faring relatively well in this deeply challenging year. Both the IMF and our call peg Japan as the "second-least-hard-hit G7 economy" this year, with an expected GDP drop of around 5%. (The U.S. is likely to fare "best" with a drop of 4%, which at the very least raises some doubt over the mantra about there being no trade-off between the economy and health concerns.) Among the G7, Japan has had the mildest experience with the virus, a strong fiscal response, and also is a modest winner from the shift from services to goods.

- **Europe** now has more new virus cases per capita than the U.S., and is seeing a wave of renewed restrictions. The pain has spread even to Germany, which has fared better than most, with Chancellor Merkel indicating (unnervingly) that her main goal was now to avoid an economic meltdown similar to Q2. Even limited lockdowns threaten to further clip an EU economy that was already facing one of the deepest downturns in the world this year, with each of France, Italy and the U.K. looking down the barrel of 10% GDP declines. Loaded on top of the shutdowns, the latter is also now facing the growing risk of a no-deal Brexit as the countdown clock rapidly approaches midnight (Dec 31).

- **Canada:** Almost immediately after our publishing cut-off time last week (of course), Ontario announced major new restrictions amid a sustained rise in new virus cases. Along with earlier moves by Quebec, this could clip October GDP by 0.3%-to-0.4%, potentially stalling the recovery for a spell. True, this hit is in a different league from the cumulative 18% plunge in activity during the March/April closures. But, with case counts rising broadly, this may not be the last word on restrictions, and near-term risks look skewed to the downside. Still, the economic pain can remain manageable as long as schools, stores and factories remain open. And, it's clear from sales in big-ticket items like houses and autos, that consumers have learned how to operate amid distancing measures. In fact, housing has rebounded to such an extent that concerns have shifted to things being too hot for comfort, with sales at a record high last month and the market at record tightness by some measures. For the overall economy, the latest consensus has firmed slightly to a 5.8% GDP drop this year and a 4.9% rebound next year. We are a bit stronger on both at -5.6% and 6.0%. While the second wave gives us serious pause on that relative optimism, there is one thing that gives us comfort—the **ongoing and massive fiscal support** in Canada. The IMF now reckons that among the biggest 15 economies, Canada has had the most forceful fiscal stimulus to-date (with the U.S., Japan and Australia in hot pursuit). Even so, the IMF still looks for the Canadian economy to drop 7.1% this year (and rebound 5.2% next). That's notably weaker than consensus, leaving room for another upgrade later on, we believe, even with the concerning virus developments.

The title of this week's effort naturally refers to the classic **Phil Collins** song from almost 40 years ago, which has somehow managed to make the news a few times this year and has found a new fan base. The dark lyrics work quite well for this troubled year and, in particular, amid the ongoing battle over (the lack of) new stimulus in Washington:

- *And I've been waiting for this moment for all my life*
- *Well, if you told me you were drowning, I would not lend a hand*
- *So you can wipe off that grin, I know where you've been; It's all been a pack of lies*
- *But I know the reason why you keep your silence up, no, you don't fool me; Well, the hurt doesn't show, but the pain still grows*
- *And I can feel it coming in the air tonight… Well, I've been waiting for this moment for all my life*

This past week, things took a new twist, as said Mr. Collins asked the Trump campaign to cease and desist using the song at events. Well, since that one isn't available, there's always another hit from the same era, also from the U.K., which has somehow become weirdly appropriate after all… **The Police's** "*Don't Stand So Close to Me*".

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