THE DAILY CHECK-IN WITH GOLDMAN SACHS

GUEST: SILVIA ARDAGNA, MANAGING DIRECTOR IN THE INVESTMENT STRATEGY GROUP IN THE CONSUMER AND INVESTMENT MANAGEMENT DIVISION

HOST: LIZ BOWYER, GLOBAL HEAD OF BRAND AND CONTENT STRATEGY

RECORDED OCTOBER 16, 2020

LIZ BOWYER: Hi Silvia.

SILVIA ARDAGNA: Hi Liz.

LIZ BOWYER: Silvia, you're an investment strategist within the Investment Strategy Group at Goldman Sachs with a focus on Europe. What's your outlook on the European economy right now?

SILVIA ARDAGNA: The main message of our economic outlook is that we expect the recovery to continue, but at a softer pace than we have observed in Q3. On average, in 2020, we expect that the economic activity will contract by about eight and a half percent in the euro area, but we'll recover in 2021 by about six and a half percent. In the UK we expect a decline in activity of about 11 percent in 2020. And a recovery of about seven percent in 2021.

Now when we compare these numbers to the consensus, these are slightly more pessimistic. However, these are in line with the forecast for growth that the IMF has just released.

It is very important to note that in our view there will be a significant degree of heterogeneity across European countries, and more generally across DM economies. Based on our forecast, we expect that real GDP will get back to its 2019 level sooner in the US by mid 2021 than in other major developed economies like the UK or France.

LIZ BOWYER: And what are the factors driving the Investment Strategy Group's outlook?

SILVIA ARDAGNA: First, the evolution of the pandemic that hits countries at different times and with different intensities. Second, different economic structures with countries more open to trade, more exposed to tourism [UNINTEL], being hit the most in 2020 and recovering more slowly thereafter. And finally, heterogeneity in the size and in the composition of these [UNINTEL] with countries with more fiscal space being able to provide more support for households and firms than others, and hence recovering at a faster speed.

In a nutshell, we think that COVID-19 will amplify the economic performance gap that opened up after the global financial crisis across major developed nations and within the Euro area countries.

LIZ BOWYER: And how about Brexit? Still no trade deal as of now. How does that factor into your views?

SILVIA ARDAGNA: We remain of the view that there is still time for a trade agreement to be reached before the end of the year. Now, obviously, the deadline is fast approaching because as we all know in about two months the European Union will not be the home of the UK anymore. And currently, there is disagreement in three main areas. Mainly, fishing rights, the use of state aid, and the [UNINTEL] to which the two parties have to adhere starting from January 1st. When we look at the latest round of negotiations, not much progress has been done in these three areas, and particularly on fishing rights. However, the good news is that the two parties are still discussing, and this is why we think that the deal is still possible and likely to be reached by mid November.

LIZ BOWYER: So, how do you think things will evolve?

SILVIA ARDAGNA: Well, the bad news is that at this stage we think that an agreement is likely to be minimal. And will most likely be revised over time. Because the only two potential options are either the possibility or exchange goods without impositions of tariffs or quota, but meaningful non-tariff barriers being introduced. Or trade governed by WTO. Now, in this latter case, which again is not our base case, we think that the costs in terms of output lost, particularly for the UK, would be non-trivial. And so, if there were to be a no deal Brexit, this would clearly be a downside risk to our 2021 outlook.

LIZ BOWYER: And to what extent are you worried about debt levels as developed countries across the world, including in Europe, hold onto record amounts of debt in order to stimulate their economies?

SILVIA ARDAGNA: I think it's important to recognize that not all public debt is the same. Using the words of the former president of the ECB, Mario Draghi, there is good debt and there is bad debt. Now, the sizable increase in debt that is taking place both in the US and in Europe has been instrumental to support this positive economic recovery. The fiscal stimulus that countries have provided has prevented a more dramatic slump in household consumption and has kept valuable firms in business, avoiding more long-lasting scars and the so-called hysteresis effect that would have delayed any kind of recovery. Also, we know that interest rates are very low. And this certainly helps debt sustainability and facilitates the rollover of maturing securities.

LIZ BOWYER: So, even if you're not worried about public debt leading to a financial crisis, to what extent are you concerned about it contributing to rising inflation?

SILVIA ARDAGNA: The short answer is that we are not worried about high public debt delivering a high inflation like the one we have seen in the '70s or '80s. And there are a variety of reasons why we think so. First, the crisis has led to a very large negative output gaps in all major developed economies. And we think it would take time for these output gaps to close. So, there will be not much pressure on prices in the very near term.

The second reason is that an important determinant of inflation are inflation expectations. And both in the US and in the Euro area, inflation expectations are anchored at the policy target or well below the policy target. This is the case of the Euro area.

Third, although in this crisis fiscal and monetary authorities acted in a very complimentary way to support the real economy with easing policies, monetary authorities are independent from the political power. This implies that if and when inflation were to deviate to the upside for their mandate, we think that they would tighten monetary policy to remain committed to their remits.

LIZ BOWYER: So Silvia, given all of this, what's the recommendation that the Investment Strategy Group is making to clients?

SILVIA ARDAGNA: The most important message that we are giving to our clients who are long-term investors, they're not traders, is that with the favorable economic backdrop like the one we expect when there is ample support from monetary and fiscal policies, very low rates, modest inflation, they have to remain invested at the right strategic asset allocation. Now, this means that whatever equity location, our clients, risk tolerance is, our advice is to keep debt/equity allocation and to overweight the US stock market. And this is because we don't just expect the US to outperform Europe in the very near term, 2021, but because the US scores best among other countries from a demographic perspective, from its ability to innovate and compete in global markets, from the flexibility of its economy from a competitiveness perspective.

And so, we think that the outperformance of the S & P versus the EAFE or EM equities that we have observed in the past ten years after the global financial crisis is likely to continue.

LIZ BOWYER: Thanks Silvia.

SILVIA ARDAGNA: Thank you very much Liz.