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Market update: 14th October 2020

Growing Calls for Fiscal Stimulus

So far this year, policy makers around the world have put in place unprecedented policy measures to combat COVID-19 cases and support their economic prospects through the ongoing pandemic. Despite the significant fiscal push so far, moving into the winter months as virus cases have risen, calls are growing louder as some argue that greater stimulus is required to improve the productive potential of nations, although others are concerned about increasing debt levels.

Global fiscal policy

Globally, governments have remained throughout the pandemic. Global governments announced $10 trn worth of spending in the first two months of the coronavirus outbreak alone. In the UK, the first five months of the fiscal year sent accumulated borrowing to £174bn, whilst the level of borrowing hit almost £36bn in August. In the US, more than $2trn has been added to the federal ledger to prop up the economy, with an additional $2trn package expected in the near future. Additionally, in the EU a €750 billion recovery effort has been established, which amounts to a combined recovery package of €1.83trn for the EU.

Authorities have acknowledged the importance of continuing to provide accommodative fiscal and monetary policy to help combat the crisis. Few disagree that the policy responses so far have helped pull economies out of a deeper downturn, however it appears it is important for the support to continue in the short-term. The IMF recently downgraded its outlook for 2021, and its latest research paper has taken the stance that affluent nations should continue to spend to boost their economic outlook.

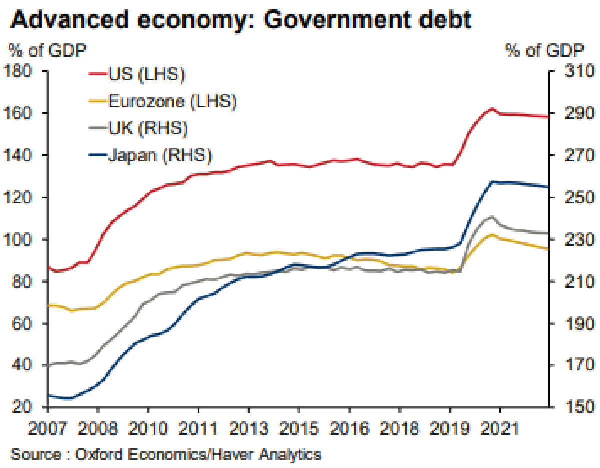
The IMF's View for The Global Economy

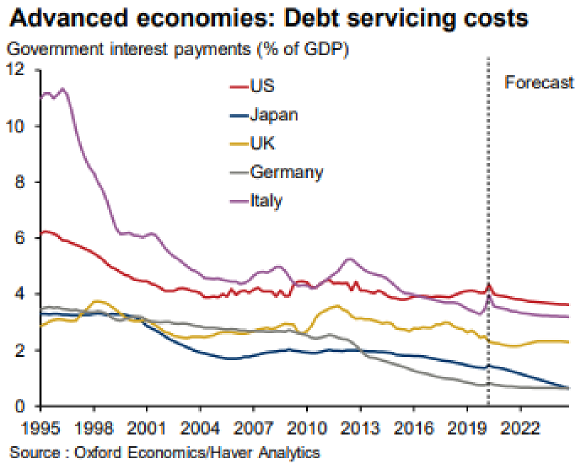
The IMF typically tells nations to cut spending to avoid accumulating significant debt, however this time is different. In a recent external publication, the IMF has suggested affluent nations should worry less about debt levels and more about setting the foundations for a sustained recovery from the crisis. In particular, it has highlighted that public spending should be allocated to projects which assist the recovery, such as digital infrastructure and sustainability.

The IMF noted that prior to the coronavirus there was a decreasing trend of public investment as a share of GDP, suggesting affluent nations have not been investing enough into infrastructure. Its current stance, which is contrarian to their typical view, sees an increase in public spending in the appropriate sectors leading to an increase in economic growth, which in turn will decrease a nation's debt-to-GDP ratio. Alongside this, with interest rates near the lower bound, it makes it cheaper for governments to borrow, which could provide them with a higher return on their investment. They argue this form of public spending will be more effective than simply providing transfers or tax cuts to households, which several nations have been utilising so far.

Fiscal Policy Intentions

Globally, a number of industries and investment areas have been identified as providing nations with an opportunity to improve their economic recovery. One of these is investing in the foundations of sustainability. For some time, we have known about the importance of improving our sustainability, and if climate targets are not met, the damage inflicted so far could be irreversible. More than half of





the world's total GDP is moderately or highly dependent on a stable environment and is therefore vulnerable to disruption due to climate change. Without action to address climate change, an additional 100 million people could be pushed into poverty by 2030 and 143 million in just three regions could be displaced. The pandemic has brought environmental concerns to the front of public consciousness, as the enforced pause on industrial output and travel have resulted in cleaner air and CO_2 emissions are estimated to be at the lowest level in 14 years.

Clean energy and sustainability were a growing trend prior to the pandemic, and as governments seek to identify strategies to fuel the economic recovery over the long term, they are putting ideas forward to integrate this trend into their recovery strategy. The UK government has recently committed to law a national obligation to cut carbon emissions across the UK to net zero by 2050, whilst the government has also increased its 2030 target to install an offshore wind farm with a 40GW capacity from 30GW to help meet the UK's long-term climate targets. In addition, Downing street has formed a ten-point plan to "build back greener", which will involve hydrogen production and infrastructure, carbon capture and storage and nuclear fusion capabilities.

Furthermore, in the US, a potential Biden presidency will see the US commit to a green recovery. Joe Biden has previously announced a $2trn climate plan to escalate the use of clean energy in the transportation, electricity and building sectors. He will be seeking to help revive the economy in support of ESG-backed projects. In the Eurozone, 38% of the €1.83trn recovery package has been earmarked for climate goals, in a bid to grow cleaner energy through infrastructure and production investment.

Another area which is said to be key to the global recovery is infrastructure spending, and authorities will likely drive both traditional and digital infrastructure spending. Historically, in the economic recovery phase, infrastructure spending has been a driver of growth as it creates jobs and delivers tangible assets to fuel long-term economic growth. The boost to short-term demand and long-term productivity is important, where according to a 2014 IMF study, an unanticipated increase in capital spending of 1.0% of GDP leads to a 0.4% uplift in output that same year, and a 1.5% rise four years later. Additionally, digital infrastructure is becoming increasingly important. The adoption of digital technology and AI was a fast-accelerating trend even before the COVID-19 crisis, as the shift to a contactless economy has contributed to this acceleration. In addition, the firms with an adequate digital presence and capability have arguably fared the best during 2020, as the restrictions and limitations put in place has made digital business models one of the most viable.

In the UK's budget announced in March, the government pledged to spend over £640bn on infrastructure in the next five years with additional calls to create a new 'UK infrastructure bank'. Despite experiencing a severe economic downturn since March, its likely infrastructure spending will become even more important to support the UK's economic recovery, and hence this figure may increase. The desired effect is to improve regeneration and improve growth, especially outside of the capital. In the US, both presidential candidates have pledged to spend heavily on infrastructure, with industry groups calling for big investments in bridges, highways, and other major infrastructure projects to spur a US economic revival. Most developed economies have allocated funds for digital infrastructure spending in preparation for broadband and 5G operations.

The Impact on Financial Markets

Despite an uncertain and uneven economic recovery ahead for many major economies, the sectors mentioned above along with others will likely be drivers in GDP growth rates. Already so far, investments focused on these areas have outperformed in recent months as investors begin to enter attractive positions.

ESG focused funds, which includes sustainable as well as clean energy investments, demonstrated resilient fund flows and strong growth as social issues have become more important. Some of the H1 outperformance were due to sustainable funds being underweight in energy and overweight in healthcare and technology. However, analysts have identified that businesses who had already committed to ESG had succeeded in reducing operational risk, have better resilience due to stronger relations with employees and also have more reliable supply chains, alongside a lower risk to their business reputation. That being said, as firms begin to approach the deadline for their sustainability targets in the next 10 to 20 years, it is expected fund inflows will continue as more investors seek to benefit from the increasingly important trend.

Key Risks from Increasing Government Deficits

Although the IMF's view has received backing from policy makers and authorities around the world, some economists are concerned that the GDP growth and hence debt-to-GDP ratio may not have the desired effect. They have voiced that deficits may narrow more slowly than their forecasts imply for two main reasons. First, if the recovery disappoints, then the fiscal position's cyclical improvement will underwhelm. Some economists suggest that the downside risks to the economic outlook may outweigh upside risks by a wide margin, suggesting that deficits are more likely to be larger, rather than smaller, compared to their baseline forecasts. Second, governments may choose to delay any discretionary fiscal tightening. One reason for this is that compared to a decade ago, markets appear far less likely to punish governments for perceived fiscal profligacy. An additional risk is significant inflation, such that governments should be cautious with supportive fiscal policy when the economy is close to full employment, as an inflation surge becomes a risk. Albeit we do not expect to see significant inflation until 2022/23, so this may not be an immediate concern.

Our view

Overall, we do not see affluent nations around the globe withdrawing their fiscal support anytime soon, as it is arguably imperative for a nation's growth prospects. Increase fiscal spending can boost both short-term and long-term growth and can significantly increase a nations productive potential. Although it is still early in the economic recovery, policy makers appear to be in agreement with the IMF's view that fiscal policy is to play a key role in improving the economic outlook. Authorities also appear to be acting or are planning to act in unison also, as we see further initiatives worldwide for investments into key thematic trends such as value-oriented holdings, sustainability, and infrastructure. As such, our positioning seeks to benefit from these key trends which are becoming increasingly popular among investors, and we continue to monitor markets for new trends and opportunities. We expect to see continued uncertainty and volatility in the near term; however, it is our view that the current and future policy actions will help drive equity markets higher in the medium and long term.