THE NARRATIVES OF 2020

Narratives – the stories people tell about events – may influence behaviour. In future years, several narratives may very well be used when looking back at economic developments in 2020. Big, unanticipated shocks do happen. In terms of monetary policy, a 'whatever it takes' attitude prevails. This also applies increasingly to fiscal policy. In terms of financial markets, the dominant attitude towards risky assets is to buy rather than to say 'bye bye'. With Next Generation EU, the European Union has again demonstrated that, under pressure, it can make big leaps forward. Finally, attention to sustainable growth has become ubiquitous. Some of these narratives provide comfort but several also come with a warning.

In his presidential address to the annual meeting of the American Economic Association in 2017, Nobel laureate Robert Shiller argued that one should consider the possibility that the severity of a recession is related to the prevalence and vividness of certain stories. These form a narrative, a term that refers to *"a simple story or easily expressed explanation of events that many people want to bring up in conversation or on news or social media because it can be used to stimulate the concerns or emotions of others, and/ or because it appears to advance self-interest."*[1] Narratives are relevant because they can influence future behaviour. Past traumatic experiences – e.g. losing money in a stock market crash – can influence how, many years later, certain investors deal with risk and uncertainty. In future years, at least six narratives may be used when looking back at economic developments in 2020.

First, black swans exist or, to put it differently, big, unanticipated shocks do happen. As these shocks are so rare, it is difficult to prepare for them, e.g. by buying insurance. The pandemic-induced shock to demand and supply was of a size that would have been considered unthinkable 12 months ago. The disruption of supply chains was a wake-up call of the necessity to test their resilience considering that climate events or cybersecurity attacks could also trigger tail risks.

Second, in terms of monetary policy, the 'whatever it takes' reaction prevails. Quantitative easing is used by an increasing number of central banks, including in emerging markets. The Federal Reserve has committed to accept a moderate and temporary overshooting of its inflation target in order to have average inflation over time in line with its 2% objective. Its corporate bond purchases have played a key role in stabilising this market, thereby avoiding a further blow to the liquidity and solvency of many issuers. This week, it announced that asset purchases will continue at least at the current pace until substantial progress has been made in reaching the maximum employment and price stability goals. The ECB's Pandemic Emergency Purchase Programme has been instrumental in controlling the longer end of the yield curve –despite the sizeable increase in issuance volume- and in driving down sovereign spreads versus Bund yields.

1. Robert J. Shiller, *Narrative economics, American Economic Review*, 2017, https://doi.org/10.1257/aer.107.4.967

Third, 'whatever it takes' has been extended to fiscal policy. The huge increase in budget deficits was partly automatic and hence unavoidable –because of the role of automatic stabilisers- but it was also the result of much-needed policy decisions to cushion the consequences of the sudden and very deep recession on household and businesses via income support, changes in taxation and loan guarantees.

Fourth, in terms of financial investments, the dominant attitude has been to buy risky assets – equities, corporate bonds, emerging markets – rather than to say 'bye bye' to the market. This is largely related to the monetary and fiscal policy support, including the commitment of central banks to do more if necessary, but also to an environment of negative real interest rates.

Fifth, the European Union has again demonstrated that, under pressure, it can make big leaps forward, witness the EUR 750 Next Generation EU initiative that is financed at the EU level and partly consists of grants.

REAL GDP (Q4 2019 = 100)

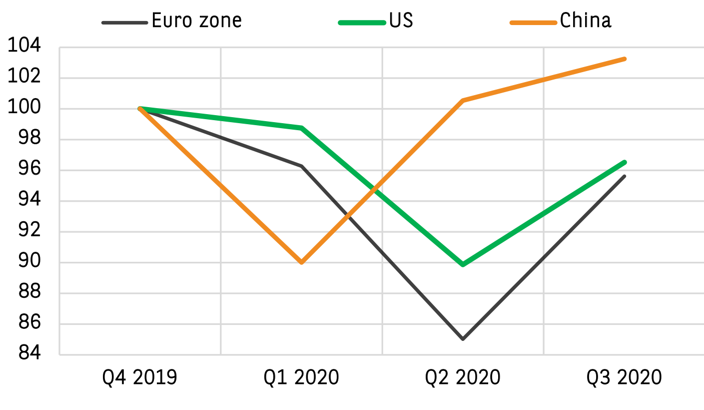

CHART 1

SOURCE: EUROSTAT, BEA, NBS, BNP PARIBAS

> Several of the narratives of 2020 come with a warning, such as the need to pay attention to possible unintended consequences of sustained very accommodative monetary policy, to moral hazard risk and to the necessity to bring public finances under control.

Finally, attention to sustainable growth has become ubiquitous. Companies which scored high in terms of ESG criteria suffered less during the equity sell-off in February and March. The pandemic should make people more aware of how global warming could also provoke "Black Swan" events. Climate related disasters such as heat waves, floodings and drought are likely to claim many human lives and cause enormous economic damage in the coming decades. The necessity to contribute to limiting the increase of average temperature and, more generally, to care more about the environment in order to protect the well-being of its people has played a key role in setting the priorities of fiscal stimulus at the national – think of France and Germany – and European level. Unfortunately, even despite all the efforts to limit global warming to less than 1.5°C, it will take at least until the middle of the century that carbon neutrality can be reached and the global temperature curve can start showing signs of reversing.

To conclude, certain stories about 2020 that may be told in future provide comfort: the prospect of enhanced resilience of the supply side, the ability of the EU countries to act jointly, the focus on sustainability, the 'can do' approach of 'whatever it takes'. However, several narratives also come with a warning, such as the need to pay attention to possible unintended consequences of sustained very accommodative monetary policy, to moral hazard risk and to the necessity to bring public finances under control.

William De Vijlder

CENTRAL BANK BALANCE SHEET (END 2019 = 100)

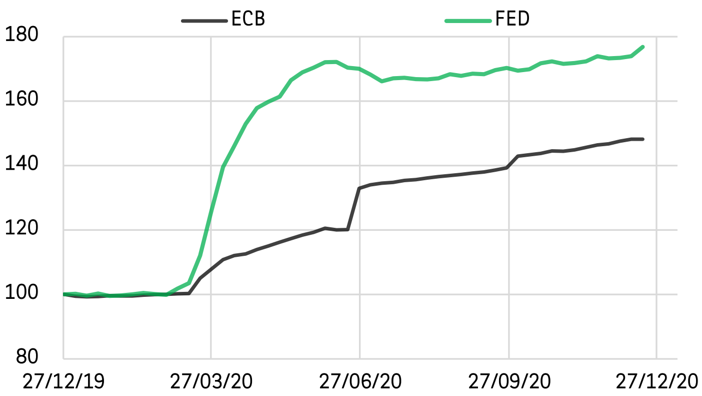

CHART 2 SOURCE: ECB, FEDERAL RESERVE, BNP PARIBAS

FISCAL BALANCE AS % OF GDP IN 2020

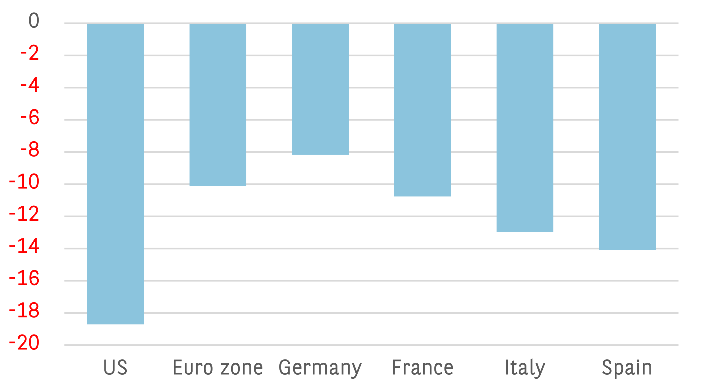

CHART 3 SOURCE: IMF (FISCAL MONITOR), BNP PARIBAS

EQUITY MARKETS

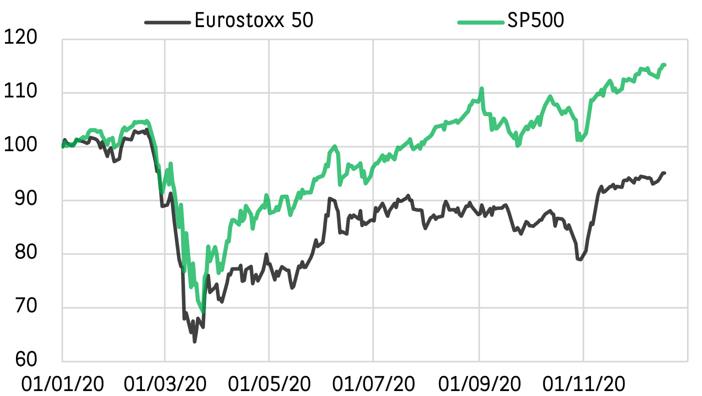

CHART 4 SOURCE: REFINITIV, BNP PARIBAS

2020 IS AMONG THE WARMEST YEARS ON RECORD

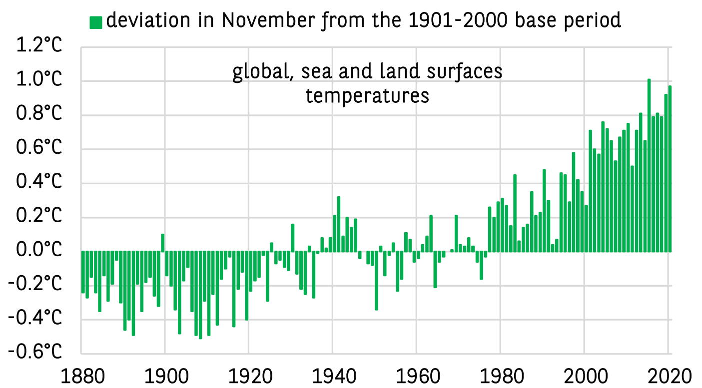

CHART 5 SOURCE: US NATIONAL OCEANIC AND ATMOSPHERIC ADMINISTRATION, BNP PARIBAS