AllianceBernstein

GLOBAL ECONOMIC RESEARCH

GLOBAL MACRO OUTLOOK

OCTOBER 2020

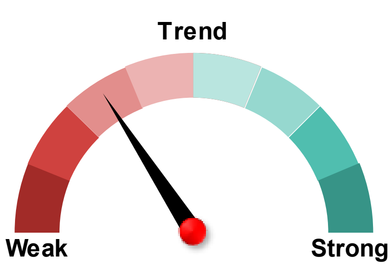
KEY FORECAST TRENDS

- The global economy bounced back strongly in the third quarter but is now entering a more difficult phase as a resurgence in COVID-19 infections and gradual withdrawal of emergency policy support limit the pace of the rebound.
- That's likely to mean a more modest pace of expansion in the US and a temporary contraction in Europe. In China, where output is back above precrisis levels, a sustained recovery looks likely.
- We continue to think that damage from COVID-19 will linger for a few months more and that additional policy support will be necessary. With monetary policy nearing the end of the road, fiscal policy is the key variable to watch.
- If fiscal policy plays its part, the recovery should pick up pace again in the second quarter of 2021, barring a significant deterioration in the public health situation that would lead to renewed economic restrictions.
- Central banks continue to grapple with persistently low inflation, made worse by the impact of COVID-19. The US Federal Reserve (Fed) has already switched to an inflation make-up strategy and the ECB may be mulling a similar move.
- Warm words won't push inflation higher. But, combined with large-scale bond purchases, they can ensure that interest rates remain at ultralow levels for the foreseeable future and thus facilitate fiscal expansion. For now, that's the main role for central banks.

CONTENTS

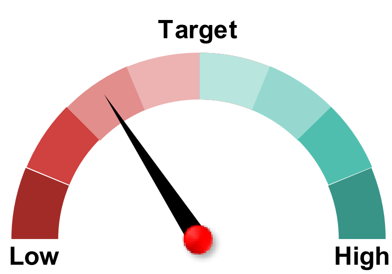
THE GLOBAL CYCLE

ECONOMIC ACTIVITY



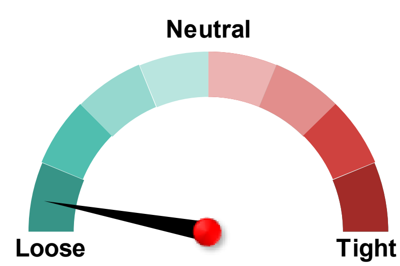
- Despite a strong initial rebound, the road to a full recovery is likely to be long and uneven
- For many countries, output may not return to precrisis levels until well into 2022

INFLATION



- Elevated debt and a major shift in the underlying policy regime point to higher inflation medium term
- But dislocations caused by COVID-19 suggest that near-term inflation risks are skewed to the downside

MONETARY POLICY



- With interest rates at or below zero in many countries, monetary policy is close to the end of the road
- But central banks still have a vital role to play by anchoring bond yields and supporting fiscal policy

GLOBAL FORECAST

FORECAST OVERVIEW

Key Assumptions

- **COVID-19**: resurgent virus likely to weigh on growth over the near term then fade as a macro factor
- **Economy:** some disruption likely as emergency policy support is gradually wound down
- **Fiscal policy:** fiscal stimulus to provide sustained policy support throughout the recovery phase
- **Monetary policy:** central banks to keep yield curves anchored to facilitate fiscal stimulus
- **US election:** a non-disruptive outcome

Central Forecast

- **Global growth:** after strong post-lockdown gains, growth likely to turn patchy in 4Q/1Q
- **US/Europe:** a more modest pace of expansion in the US and small contraction in Europe look likely
- **China:** sustained recovery helped by ongoing policy support
- **Fed:** rates to remain at zero for the foreseeable future; QE to continue
- **ECB:** further increase in bond purchases likely around year end; rate cut still possible

Upside Risks

- Medical innovation
- Policy effectiveness
- Return of multilateralism

Downside Risks

- Virus spread
- Accidental/premature austerity
- Populism/geopolitics

Core Views

- Yields to stay near / below zero
- Stronger euro against the dollar
- Favor hard-currency EM debt

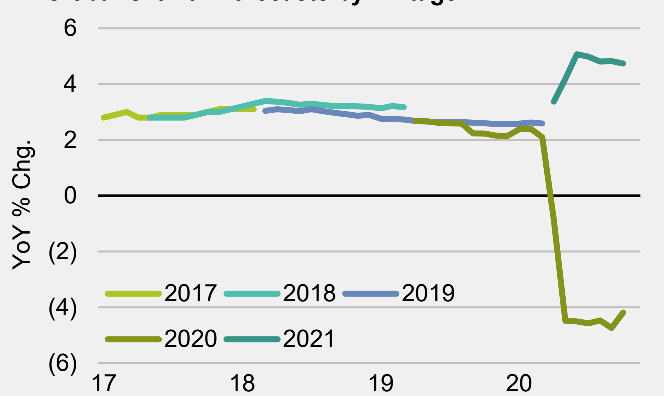
AB Growth & Inflation Forecasts (%)

	Real GDP Growth		CPI Inflation	
	2020	2021	2020	2021
US	(3.8)	3.7	0.5	2.5
Euro Area	(7.5)	4.3	0.3	0.7
Japan	(5.6)	2.2	0.2	0.5
China	2.0	8.0	2.8	2.3
Global	**(4.3)**	**4.7**	**1.7**	**2.3**
Industrial Countries	(5.5)	3.7	0.4	1.7
Emerging Countries	(2.4)	6.4	3.8	3.4
EM ex China	(5.9)	5.0	4.6	4.4

As of September 30, 2020
Source: AB

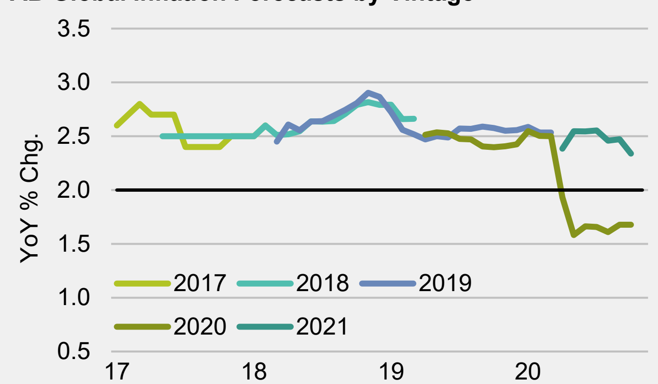
FORECASTS THROUGH TIME

AB Global Growth Forecasts by Vintage



Forecast years start in April: i.e., the first forecast for calendar-year 2017 is March 2016 and so forth.
As of September 30, 2020
Source: AB

AB Global Inflation Forecasts by Vintage



Forecast years start in April: i.e., the first forecast for calendar-year 2017 is March 2016 and so forth.
As of September 30, 2020
Source: AB

GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

Global—A key legacy of COVID-19 will be a huge increase in government debt. This would normally put upward pressure on bond yields, but large central bank bond purchases have helped prevent this. Implicit or explicit yield-curve control is likely to be a permanent feature.

US—The Fed's shift to average inflation targeting is designed in large part to push inflation expectations higher. While this would normally be expected to push interest rates higher as well, we expect the central bank to continue purchasing Treasuries and to prevent rates from moving materially upward to support the economic recovery.

Euro Area—With headline inflation negative and core inflation at a record low, the European Central Bank (ECB) is likely to expand and extend its asset purchase program around year-end, placing a cap on core and peripheral bond yields.

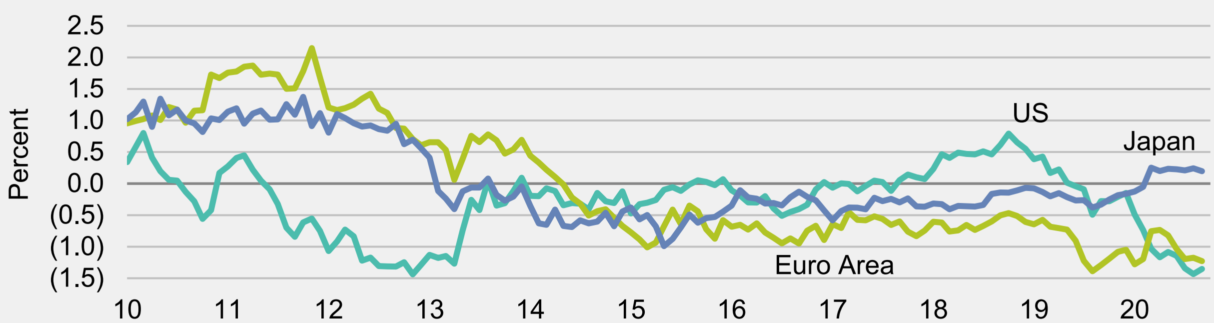
Japan—Tweaks from the Bank of Japan (BOJ)—dropping the Y80 trillion per annum purchase target—largely validate the status quo. Yield-curve control (YCC) should anchor 10-year bond yields close to zero for the foreseeable future.

10-Year Yields: AB vs. Consensus Year-End Forecasts (%)

	AB		Consensus	
	2020	**2021**	**2020**	**2021**
US	0.50	1.00	0.76	1.16
Euro Area	(0.50)	(0.35)	(0.40)	(0.17)
Japan	0.00	0.00	(0.01)	0.03
China	3.00	2.80	2.97	3.01

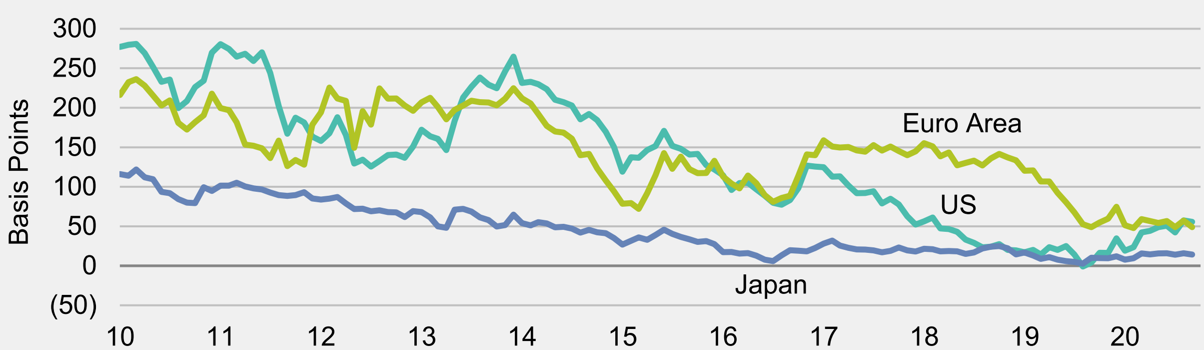
As of September 30, 2020
Source: Bloomberg and AB

Real 10-Year Bond Yields*



*Current 10-year bond yield less five-year/five-year-forward inflation swap
Through September 30, 2020
Source: Bloomberg and AB

Yield Curves: 10-Year Bond Yield Minus Two-Year Bond Yield



Through September 30, 2020
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CURRENCIES

FX FORECASTS

USD—The Fed's efforts to boost inflation expectations opened the door for broader dollar weakness, though its magnitude is likely to be limited by other central banks' willingness to implement similar policies.

EUR—The euro has struggled to make further headway in recent weeks as a pickup in COVID-19 cases, mixed data and ECB commentary have weighed on sentiment. But we continue to think that an improved governance framework warrants a further appreciation of the euro, especially with the Fed's shift to average inflation targeting likely to weigh on the dollar.

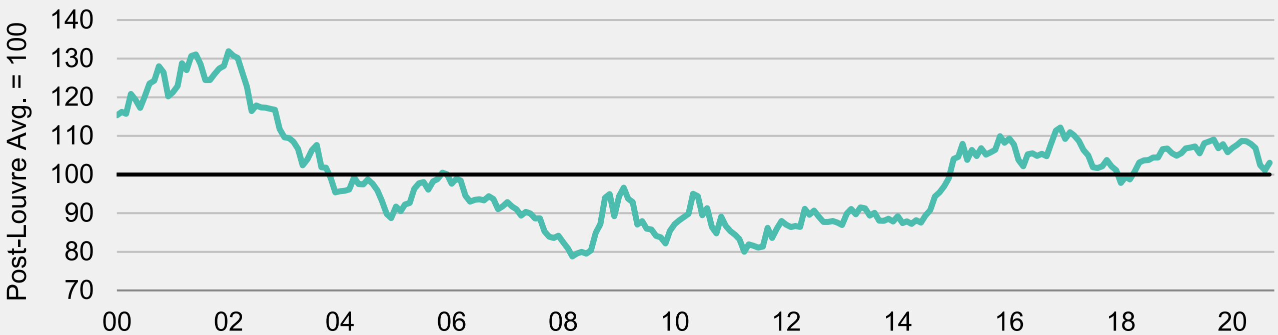
JPY—We see few Japan-specific reasons for a big shift in the yen. Policies in developed economies have converged with those in Japan. That said, we still think the yen retains its risk-off characteristics.

Global FX: AB vs. Consensus Year-End Forecasts (%)

	AB		Consensus	
	2020	2021	2020	2021
EUR/USD	1.30	1.30	1.19	1.23
USD/JPY	102	101	105	105
USD/CNY	6.75	6.70	6.82	6.70
EUR/GBP	0.96	0.96	0.91	0.90

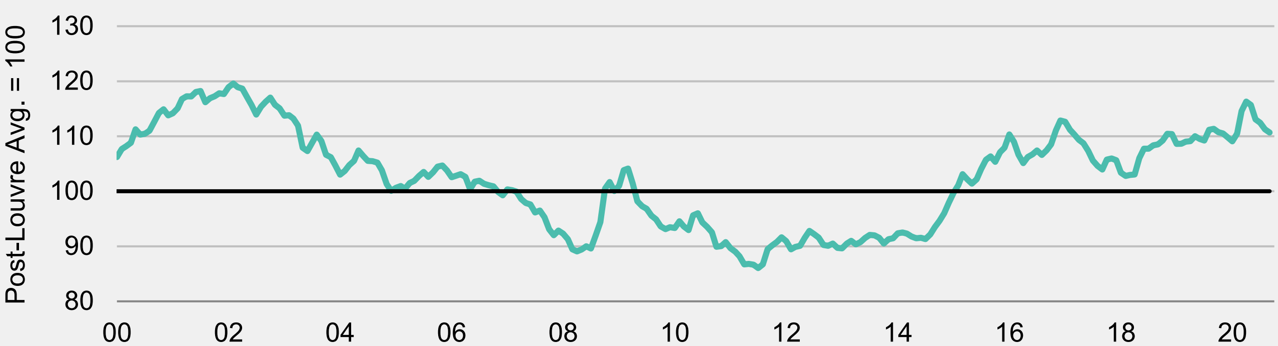
As of September 30, 2020
Source: Bloomberg and AB

Nominal USD Exchange Rate: US Dollar Index



Through September 30, 2020
Source: Bloomberg and AB

Real USD Broad Trade-Weighted Exchange Rate



Through September 30, 2020
Source: Haver Analytics and AB

US

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
US	(3.8)	3.7	0.5	2.5	0.13	0.13	0.65	1.00

OUTLOOK

- We have revised upward our forecast for 2020 growth on the back of strong growth in the third quarter. But we view much of this year's strength as pulling forward growth from next year and therefore have downgraded our 2021 forecast.
- The key issue in assessing the growth outlook is fiscal policy. Most of the stimulus measures that proved so effective at supporting growth in 2020 have expired, and with more than 10 million people still unemployed as a result of the COVID-19 crisis, we believe that additional fiscal support is necessary to sustain growth into next year.
- Both the economy and markets have been resilient in the face of a volatile political cycle, with fiscal and monetary support the critical factors underlying that resilience.

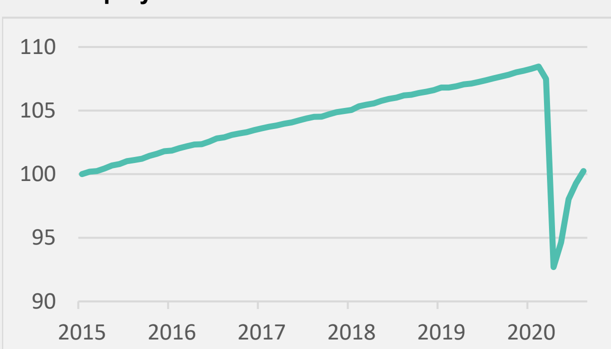
RISK FACTORS

- The coronavirus remains a macro variable, with economic activity still vulnerable to public health policy needs in the near term. Over the medium term, the prospect of medical innovations that could reduce the impact of the virus on the macroeconomy is the largest upside risk to the growth outlook.
- With the election less than a month away, the probability of a contested result appears to be rising. Markets might be able to adapt to any outcome, but their adaptability to an extended absence of a clear outcome is more uncertain.

OVERVIEW

The US economy performed strongly in the third quarter and has now regained roughly two-thirds of the losses sustained in the early days of the COVID-19 crisis. Regaining the additional lost activity is going to be more difficult, however, especially with the virus not yet in the rear-view mirror. Sectors like travel and leisure are going to be deeply distressed for some time, and the longer the recovery takes, the larger the share of any damage is likely to be lasting. More than 10 million people are still out of work from the pandemic, and a rising share of them are now classifying their layoffs as permanent, not temporary. So far, household incomes have withstood the turmoil with fiscal support. But with support fading, the road ahead looks harder. We remain hopeful that Congress and the Trump administration will find a way to provide additional support. Until they do, the risk of a premature withdrawal of stimulus is the largest downside risk to the outlook, with a potentially messy election process not helping the situation. The largest upside risk would be a medical innovation that allowed for the virus to recede from everyday consciousness more quickly.

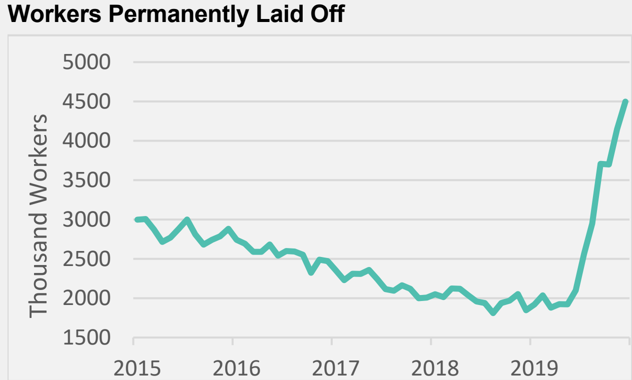
Total Employment



Through August 15, 2020

Source: Refinitiv Datastream

Workers Permanently Laid Off



Through September 15, 2020

Source: Refinitiv Datastream

Euro Area

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Euro Area	(7.5)	4.3	0.3	0.7	(0.50)	(0.50)	(0.50)	(0.35)	1.30	1.30

OUTLOOK

+ The euro-area economy contracted by a record 11.8% in the second quarter but looks set to bounce back strongly in the third quarter. We expect an increase of slightly more than 10%, which would leave the level of output 5%–6% below precrisis levels. This is a much better performance than we anticipated a few months ago.
+ It will be difficult for the euro area to maintain this momentum in the fourth quarter. In fact, with an increase in COVID-19 cases forcing governments to reintroduce some restrictions on economic and social activity, a temporary output contraction is likely during the final quarter of 2020.
+ We expect the economy to move to a more sustained recovery path starting next spring based on two key assumptions: a gradual winding down of restrictions on economic and social activity and significant fiscal stimulus. While the first of these assumptions is dependent on the virus's still uncertain path, the European Unions' (EU) new recovery fund and ECB bond purchases should ensure that all euro-area countries can deliver much-needed fiscal support.
+ With headline inflation in negative territory and core inflation at a record low 0.2% with very slow expected pickup in the coming quarters, there is a compelling case for additional monetary stimulus. We expect the ECB to expand and extend its pandemic emergency purchase program around the turn of the year.

RISK FACTORS

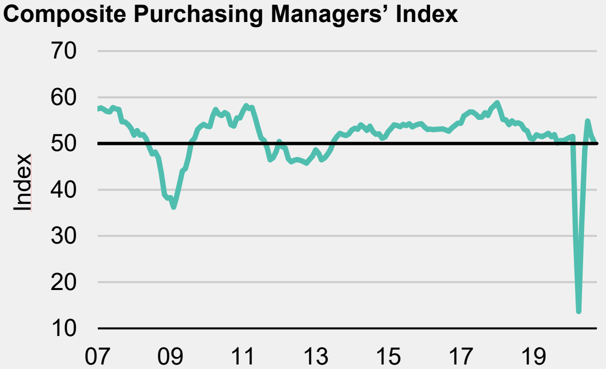
+ Our forecasts assume that rising COVID-19 infections won't overwhelm public health services and force new national lockdowns. If this is wrong, growth could be materially weaker than expected.
+ Some recent data point to strong momentum and pent-up demand as countries emerge from lockdown. If this is sustained and accompanied by strong fiscal stimulus, growth could return quickly to precrisis levels.

OVERVIEW

Recent hard data suggest that the economy has bounced back strongly since spring. That's particularly true for retail sales, which have risen 27% since April's trough and are now 4% above the fourth quarter of 2019. There have also been strong rebounds elsewhere, though in most cases the recovery is incomplete. Despite strong gains, manufacturing output, construction output and car registrations are still 7%, 3% and 9% lower, respectively, than they were in the fourth quarter of last year.

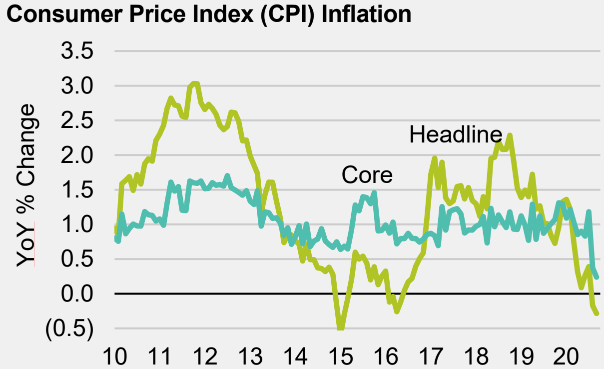
Survey data have been mixed. The composite Purchasing Managers' Index (PMI) fell for the second consecutive month to 50.4 in September, from 51.9 in August, but the economic sentiment indicator rose to a six-month high of 91.1. The latter is, though, still well below "normal" levels (the long-term average for this series is 100) and the overall message from the survey data is that the recovery is on track, but has slowed at a time when output is still well below precrisis levels.

Composite Purchasing Managers' Index



Through September 30, 2020
Source: Haver Analytics and IHS Markit

Consumer Price Index (CPI) Inflation



Through September 30, 2020
Source: Haver Analytics

China

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
China	2.0	8.0	2.8	2.3	4.35	4.10	3.00	2.80	6.75	6.70

OUTLOOK

+ China's official growth rate will likely be about 2.0% in 2020, down from 6.1% in 2019. The decline is mainly driven by weakness in capex and the impact from the COVID-19 epidemic. We expect 2021 growth to rebound to about 8.0%.
+ Continued monetary- and fiscal-policy easing should counter downward pressure on the economy, with the focus likely on infrastructure projects and property construction—measures most likely to help stabilize the economy.
+ Rising pork prices may push up inflation, but we don't think the increase will limit the central bank's policy easing.

RISK FACTORS

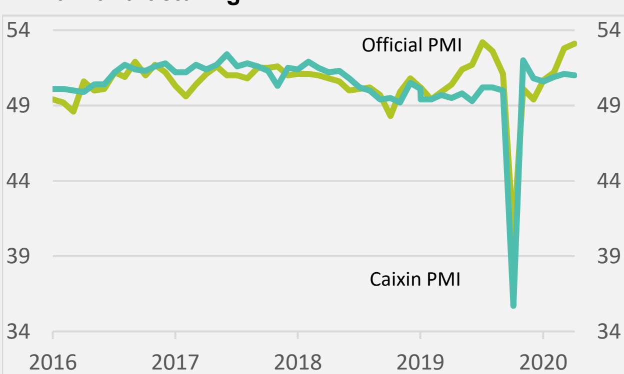
+ Policy easing may be less effective than expected if new economic data offer big surprises to the downside. This would put a sustained economic stabilization at risk for this year and the next.
+ With COVID-19 still a global pandemic, there will be further downward pressure on the Chinese economy from imported cases, weak external demand and disruption of its global supply chain.

OVERVIEW

China's economy remains on track and growth momentum is gaining in strength and depth. Many indicators point to improving economic conditions, including the official manufacturing and nonmanufacturing PMIs, which rose to 51.5 and 55.9, respectively, in September. The extended improvement in both indicators implies that the recovery is broadening and deepening, and we expect the trend to continue into the fourth quarter. Does this mean that China will deliver less policy easing? We don't think so because additional stimulus will be necessary to ensure a robust recovery.

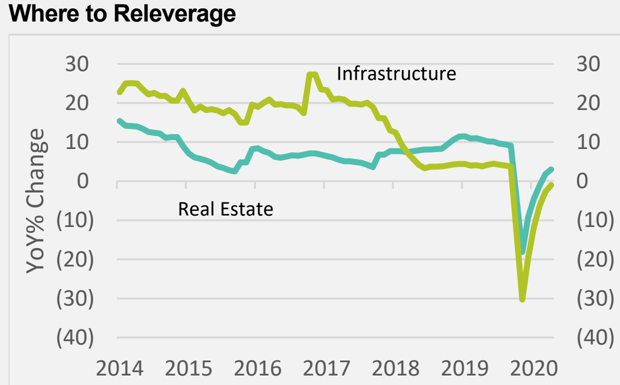
Tension between the US and China is rising, with a growing risk of US sanctions and restrictions on the activities of Chinese companies. As investors, we should be prepared for a long and bumpy road ahead: economically, politically and geopolitically. The threat of sanctions on Chinese companies is likely to escalate ahead of the US election. And while a Biden victory could lead a de-escalation of tensions, a further ratcheting up of pressure is possible if Trump is reelected. The threat of US sanctions is most pronounced for companies that are not integrated into the global supply chain or system.

China Manufacturing PMI



Through August 30, 2020
Source: Bloomberg and AB

Where to Releverage



Through July 31, 2020
Source: Bloomberg and AB

Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Japan	(5.6)	2.2	0.2	0.5	(0.10)	(0.10)	0.00	0.00	102	101

OUTLOOK

+ The new administration of PM Suga represents continuity from that of former PM Abe and few, if any, macro implications.
+ New COVID-19 cases in Japan remain elevated, albeit well below early-August peaks.
+ More fiscal stimulus will help to support the post-restriction recovery facilitated by the Bank of Japan (BOJ).

RISK FACTORS

+ A sharply stronger yen would apply an additional economic squeeze.

OVERVIEW

The change in political leadership in Japan occurred smoothly, with cabinet secretary Yoshihide Suga taking over as prime minister (PM) from Shinzo Abe, who resigned because of ill health. Indeed, the approval rating of the new cabinet jumped sharply after the handover. Overall, the transition represents continuity, rather than change, with PM Suga committing to carry forward “Abenomics.” Aside from the odd wrinkle or two, the broad thrust of policy is likely to remain unchanged—perhaps a little more regulatory reform and a little less foreign policy interest—but few, if any, macro or market implications. That is, there is ample fiscal stimulus (and perhaps we’ll see more before year-end) to support the economy through the COVID-19 crisis and post-pandemic recovery, facilitated by the “unlimited” bond buying by the Bank of Japan. Japan remains at the forefront of fiscal-monetary cooperation—“joined-at-the-hip”—and unlikely to be altered by political leadership change.

Australia/New Zealand

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Australia	(4.4)	2.3	0.5	1.6	0.25	0.25	0.88	0.88	0.73	0.73
New Zealand	(5.5)	5.0	1.3	1.5	0.25	(0.25)	0.55	0.55	0.67	0.67

AUSTRALIA/NEW ZEALAND

+ Until late June, the COVID-19 pandemic looked well under control in Australia and New Zealand—indeed, virtually eliminated in the latter. As a result, lockdowns and other restrictions were lifted, and activity was recovering smartly.
+ But in Australia, the lifting of social distancing restrictions brought a surge in cases—particularly in the state of Victoria—and a “Stage 4” lockdown was imposed in the city of Melbourne while state borders were closed. Cases have come down significantly, but state governments are taking a cautious approach to reopening.
+ In NZ, a handful of fresh cases prompted a new round of restrictions (for Auckland in particular). One side effect of that is the postponement of the NZ general election from September 9 to October 17.
+ On the monetary policy side, unconventional measures will remain in place for an extended period. Both antipodean central banks will continue to anchor yields for an extended period via their quantitative easing / yield-curve control programs. In New Zealand, the Reserve Bank of New Zealand (RBNZ) has flagged that it will likely do more—including a move to a negative-interest-rate policy in early 2021.

Canada

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Canada	(3.5)	3.3	0.5	2.5	0.25	0.25	0.50	1.00	1.30	1.30

OUTLOOK

+ As everywhere else, the COVID-19 crisis has dominated the Canadian economy. The basic trajectory Canada has followed is the same as elsewhere: a dismal second quarter followed by a robust third quarter. With the virus still circulating, the outlook for the next few quarters remains uncertain, though a continued expansion is still the most likely path forward.
+ The government's fiscal priorities recognize the need for additional support for the economic recovery, but translating those priorities into policy action may be more challenging.

RISK FACTORS

+ COVID-19 remains the biggest risk, because of both its potential domestic impact and the potential global impact.

OVERVIEW

With COVID-19 still the global economy's dominant theme, prospects for future growth are dependent on a combination of public health policy and continued government support for the economy. The Bank of Canada is committed to doing its part by keeping financial conditions accommodative, and PM Trudeau's "throne speech" indicated an understanding that a premature turn to austerity would be inappropriate. Still, translating such a broad list of fiscal desires into reality may prove challenging, and time is of the essence. A loss of economic momentum today would increase the portion of economic damage that becomes permanent rather than temporary.

UK

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
UK	(10.0)	3.5	0.8	1.6	0.10	0.10	0.25	0.40	1.35	1.35

OUTLOOK

+ After a massive 20.4% contraction in the second quarter, the British economy is likely to experience an outsize gain in the third quarter. The Bank of England anticipates a 20% increase, which would leave the level of output 3%–4% below its precrisis level at quarter-end.
+ Tougher times lie ahead. A COVID-19 resurgence—and reintroduction of restrictions on economic and social activity—along with rising unemployment as the government waters down its job retention scheme, all mean growth may turn negative again in the fourth quarter.
+ Brexit remains an important wild card. As things stand, the best-case scenario for the end of the year is a rudimentary trade deal between the UK and the European Union. This would mean a zero-tariff regime for goods but no provision for services, and the UK leaving the EU's customs union. However, it's also possible that the two sides will fail to reach agreement and that the trading relationship will default to World Trade Organization (WTO) terms.
+ Either outcome would be disruptive—both would once have been considered "hard Brexits." The precise scale of this disruption will depend partly on the final settlement and the extent to which the UK is prepared for a change in its border arrangements. The government's handling of the COVID-19 pandemic warrants some caution on this.

RISK FACTORS

+ The key risk factors likely to affect the economic outlook are the extent to which the government imposes restrictions to deal with COVID-19 and Brexit negotiations. The outlook remains clouded by inconsistent communication.

Asia ex Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Asia ex Jap/Ch	**(5.4)**	**6.1**	**2.3**	**2.5**	**2.28**	**2.08**	**2.67**	**2.50**	**—**	**—**
Hong Kong	(8.0)	5.0	0.9	0.8	1.00	0.90	0.70	0.90	7.78	7.80
India	(9.0)	8.5	5.5	4.5	3.90	3.40	3.10	.60	74.00	72.00
Indonesia	(2.0)	6.0	2.2	2.3	3.85	3.50	7.00	6.80	15,000	15,200
South Korea	(1.4)	3.2	0.3	1.0	0.50	0.50	1.25	1.25	1,150	1,150
Thailand	(7.6)	4.7	(1.2)	1.0	0.50	0.50	1.00	1.00	32.00	32.50

OUTLOOK

+ The influence of COVID-19 continues to wane. In general, the virus is contained in most countries across the region.
+ Exports of goods have recovered—particularly on the tech side. But exports of services, like tourism, remain weak.
+ Substantial monetary and fiscal support has been delivered. Questions persist around how far “unconventional” policies can be pushed, even if market concerns have subsided for now.

RISK FACTORS

+ COVID-19, US-China tensions

OVERVIEW

In general, Asia continues to perform well in controlling the spread of COVID-19. Cases in countries such as Taiwan, Thailand, and Vietnam are close to zero. South Korea and Singapore have successfully contained outbreaks—thanks to limited lockdowns, testing and contact tracing. But a new hot spot is emerging in Malaysia, and infection levels in India, Indonesia and the Philippines remain elevated. The region is not out the woods, to be sure, but the virus is becoming less of a dominant factor.

At the same time, a recovery in global trade is helping the region. Exports (particularly tech-related) have bounced sharply, benefiting countries like Taiwan. For those more exposed to services—for example, Thailand, with its heavy reliance upon international tourism—the outlook remains bleak. It’s difficult to see a rapid recovery until the emergence of widespread vaccination.

The economic policy response to date has been positive—with monetary easing and substantial fiscal support being delivered across the board. This should help underpin recovery. But across the region an end to the monetary easing cycle is close. Fiscal policy—supported by central bank action—is now dominant.

The Philippines, India and Indonesia, among others, have ventured down a path of unconventional monetary policy, intervening in domestic government bond markets to smooth volatility and facilitate ever-expanding fiscal deficit financing. Indonesia has gone the furthest here—with an explicit “burden-sharing” agreement between the finance ministry and the country’s central bank. To date, market concerns have been eased by the bank’s commitment that it is a “one off.” This may prove to be the case. But history tells us that advancing down this path seldom stops at the first step.

Latin America

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Latin America	**(7.6)**	**3.9**	**8.3**	7.0	**6.24**	**5.55**	**5.80**	**6.43**	**—**	**—**
Argentina	(9.5)	3.5	50.0	40.0	35.00	30.00	—	—	75.00	80.00
Brazil	(5.0)	3.0	2.0	3.6	2.00	2.50	6.80	7.50	5.25	5.00
Chile	(6.6)	5.1	2.7	2.0	0.50	0.75	2.50	3.00	800	775
Colombia	(6.5)	6.0	1.8	2.5	1.50	2.00	5.50	6.00	3,750	4,000
Mexico	(10.3)	3.6	4.2	3.2	4.00	4.00	5.50	6.25	21.30	21.80

OUTLOOK

+ Second-quarter GDP was weak in many countries in the region, as expected, because of national lockdowns during the early part of the crisis. Leading activity indicators are showing signs of recovery during the third quarter.

+ Monetary policy is near the end of its course as the central banks with some monetary space appear more reluctant to deliver more easing because of financial stability concerns. Fiscal policy will be limited in 2021 as credit risk concerns remain at the forefront of the economic policy debate.

RISK FACTORS

+ Politically charged debates on the future of fiscal policy are beginning as 2021 budgets are drafted. Prior to the crisis, many countries in the region were in the midst of fiscal consolidation plans, which were put on hold or reversed to avoid an even deeper recession.

OVERVIEW

In Brazil, disagreements have intensified between the political and economic wings of the government over the future of social welfare programs and the fiscal rules. President Bolsonaro has proposed an expansion of the country's direct transfer program to low-income families, which would increase current expenditures and breach the spending ceiling if expenses aren't cut from other programs. The spending cap is the most important fiscal rule in Brazil, serving as an anchor for low interest rates and investor confidence. Disagreements in congress and within the government on the programs that could be cut or reduced to offset the additional cost of the welfare program have caused negative speculation about the future of fiscal policy in Brazil. A return to loose fiscal policy would cause the central bank to raise rates and confidence in the economic recovery to be undermined. The government's economic team and many other lawmakers have reiterated their commitment to fiscal prudence. The political, populist wing of the government wants more spending. Negotiations over the coming weeks will determine which side wins.

Despite the finalization for a restructuring agreement with private bondholders, the economic situation in Argentina remains fragile. The government's 2021 budget implies a 4.5% of GDP primary balance deficit for the year, mostly financed with direct transfers from the central bank. When the budget was unveiled, the pressure on the exchange rate intensified owing to increased demand for USD. The central bank reacted by tightening capital controls to stem the drainage of reserves, while the government is enacting temporary tax cuts to exporters to incentivize the supply of USD. While these measures can buy some time and stop the downward trend in reserves, in our view, until the government announces a stronger fiscal anchor depreciation expectation will continue destabilizing the economy.

In Mexico and Colombia, monetary policy easing is close to the end of the cycle. In Mexico, monetary authorities have highlighted how goods inflation remains above the target range and, even after a large fall in activity, services inflation remains high, leaving the headline rate above the target range. In Colombia, while observed inflation and inflation expectations remain below the target range, the central bank governor has stressed that lowering real rates to negative levels could incite financial instability. In Chile, all eyes will be on the upcoming elections to define whether there will be a constitutional assembly. While the market is expecting that the option to call for the assembly will win, the focus will be on the approval rate.

Eastern Europe, Middle East and Africa (EEMEA)

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
EEMEA	**(5.1)**	**3.8**	**4.9**	**5.2**	**4.31**	**4.54**	**6.66**	**6.47**	**—**	**—**
Hungary	(5.7)	5.4	2.7	3.3	0.60	0.75	1.00	2.30	350	330
Poland	(4.5)	5.5	2.8	3.1	0.10	0.10	1.20	1.65	4.40	4.30
Russia	(4.9)	2.9	3.3	3.8	4.00	4.00	6.20	5.90	76.00	71.00
South Africa	(8.0)	2.7	3.4	3.9	3.50	4.00	9.20	9.50	17.00	17.80
Turkey	(4.2)	3.9	11.3	11.7	10.25	11.50	13.00	12.50	8.00	7.60

OUTLOOK

+ EEMEA growth and fiscal prospects have deteriorated markedly in 2020 and we think the recovery will be gradual. Lower energy prices also weigh on the outlook for the region’s oil exporters.
+ Central banks responded swiftly to the COVID-19 crisis by easing monetary policy and implementing bond purchase programs to support domestic financial liquidity. While further modest interest-rate cuts are possible in Russia, other countries such as South Africa have likely come to the end of their easing cycles. Although we don’t think the interest-rate cycle in the region has turned, Turkey has been forced to tighten monetary policy owing to exchange-rate pressures.

RISK FACTORS

+ While the extent of the economic downturn in 2020 is becoming clearer, the shape of the recovery beyond this year remains highly uncertain. Risks around our economic growth forecasts appear to be balanced as lockdown measures continue to ease.

OVERVIEW

In Turkey, continued FX weakness prompted the Turkish Central Bank (CBRT) to implement a 200 basis point hike in its policy rate to 10.25% at its September MPC meeting, with the interest corridor shifting higher by the same magnitude. The decision was a step in the right direction and was positive from a domestic signaling perspective, indicating that the political pressure not to hike has subsided given financial stability concerns about ongoing FX deprecation. Whether this will mark a more meaningful change in domestic monetary policy—as well as the broader macroeconomic picture, especially on the balance of payments (BoP) front—will depend on the CBRT’s willingness to run positive real interest rates for a sustainable period. At the time of writing, the real weighted average cost of funding remained negative, despite further tightening in domestic funding conditions in the wake of the interest-rate hike. Bringing real rates to zero could help to stop the bleeding on the BoP front but may still not be enough to bring about a turnaround in flows both in terms of the current account and capital inflows. The latter is especially relevant against lingering geopolitical risks, more recently with regards to Turkey’s involvement in the Azerbaijan-Armenia conflict. As highlighted before, we believe that Turkey would have to target positive real interest rates of 2%–3% to bring about a sustainable positive change in the BoP, reserves levels and thus the currency.

In other key developments in the region, Kuwait’s Emir, Sheikh Sabah al-Ahmed al-Sabah, died at the age of 91 following several months of ill health. We believe that while the immediate succession to Sheikh Nawaf is smooth, the announcement of a new crown prince still presents an uncertainty and will require negotiations with parliament. There are also questions over Sheikh Nawaf’s health. That said, the settlement of the succession path on the crown prince can act as a trigger to unlock the impasse between government and parliament over the debt law, which would be a credit positive. Regionally, the passing of Sheikh Sabah will leave a diplomatic void and could alter to some degree Kuwait’s status as a regional peacemaker. It also poses questions on financial support to Oman medium term which, however, had never been clearly spelled out.

Frontier Markets

In Sri Lanka, the government's first policy statements following the August parliamentary elections suggest that there is no clear strategy yet on fiscal consolidation and engagement with the IMF. It appears that the authorities will first try a "do it alone" strategy before considering a funded program with the IMF. The government stated it will rely on its foreign reserves to finance external debt repayments of US$4.5 billion in 2021, before hoping to return to the markets in the second half of 2021. The latter will not be possible, though, without significant fiscal reform and an IMF program, in our view. Eventually, we believe the government will be forced to commit to an IMF program, which will also likely entail a restructuring of domestic and external debt, given prevailing debt sustainability concerns. Considering Sri Lanka's high interest cost burden (interest as a percentage of revenues reached more than 70% in 2020), coupon reductions will play an essential role in the restructuring process of debt, while a haircut will not necessarily be a prerequisite to attain debt and fiscal financing sustainability.

Zambia's debt was on an unsustainable path long before COVID-19 started to spread across the world. But the pandemic ended any hopes of President Lungu that the country could muddle through until after the 2021 presidential election before approaching the IMF for financial assistance. As a result of the unsustainable debt trajectory, Zambia was not able to access official emergency funding sources during the crisis. Zambia has now requested a six-month debt service suspension on all commercial debt (the consent solicitation expires October 16). It seems unlikely that the consent solicitation will succeed in its current form. But even if it did, the timeline seems too short to achieve a sustainable debt trajectory. The ministry of finance projects that debt will rise from just over 100% of GDP in 2019 to around 120% of GDP by 2021 and stay at that level for at least the subsequent three years. We think Zambia's debt-to-GDP ratio will peak at a higher level (around 130% of GDP in 2021) and with gross financing needs sitting north of 20% of GDP, the potential restructuring of debt might have to include hefty haircuts.

In Costa Rica, the government has withdrawn its request for an IMF program. A few months ago, facing a pandemic-induced recession and large financing needs, the Costa Rican government presented a proposal to lawmakers and the population, intending to start a conversation about recovery. Fiscal consolidation was needed even before the pandemic to meet the country's fiscal rules, and now even more so. An IMF program would have provided the technical assistance to achieve necessary reforms, unlock low-cost financing and boost investor confidence. However, disagreements over the strategy–expenditure cuts or revenue boosting measures–have created gridlock in the National Assembly. Unhappiness with austerity has led some in the population to protest. With debt-to-GDP expected to close on 70% by the end of 2020, fiscal reform is warranted but will require further national dialogue before a plan can be executed.

AB Global Economic Forecast

October-20

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Global	(4.3)	4.7	1.7	2.3	1.55	1.47	1.59	1.71	-	-
Industrial Countries	(5.5)	3.7	0.4	1.7	(0.07)	(0.07)	0.22	0.45	-	-
Emerging Countries	(2.4)	6.4	3.8	3.4	4.07	3.82	3.77	3.66	-	-
EM ex China	(5.9)	5.0	4.6	4.4	3.92	3.64	4.50	4.50	-	-
United States	(3.8)	3.7	0.5	2.5	0.13	0.13	0.65	1.00	-	-
Canada	(3.5)	3.3	0.5	2.5	0.25	0.25	0.50	1.00	1.30	1.30
Europe	(7.8)	4.2	0.4	0.9	(0.37)	(0.37)	(0.34)	(0.19)	1.83	1.81
Euro Area	(7.5)	4.3	0.3	0.7	(0.50)	(0.50)	(0.50)	(0.35)	1.30	1.30
United Kingdom	(10.0)	3.5	0.8	1.6	0.10	0.10	0.25	0.40	1.35	1.35
Sweden	(5.5)	4.5	0.8	1.3	0.00	0.00	(0.15)	0.00	10.3	10.0
Norway	(5.0)	4.5	1.1	1.7	0.25	0.25	0.75	0.90	10.8	10.5
Japan	(5.6)	2.2	0.2	0.5	(0.10)	(0.10)	0.00	0.00	102	101
Australia	(4.4)	2.3	0.5	1.6	0.25	0.25	0.88	0.88	0.73	0.73
New Zealand	(5.5)	5.0	1.3	1.5	0.25	(0.25)	0.55	0.55	0.67	0.67
China	2.0	8.0	2.8	2.3	4.35	4.10	3.00	2.80	6.75	6.70
Asia ex Japan & China	(5.4)	6.1	2.3	2.5	2.28	2.08	2.67	2.50	-	-
Hong Kong	(8.0)	5.0	0.9	0.8	1.00	0.90	0.70	0.90	7.78	7.80
India	(9.0)	8.5	5.5	4.5	3.90	3.40	3.10	2.60	74.0	72.0
Indonesia	(2.0)	6.0	2.2	2.3	3.85	3.50	7.00	6.80	15,000	15,200
Korea	(1.4)	3.2	0.3	1.0	0.50	0.50	1.25	1.25	1,150	1,150
Thailand	(7.6)	4.7	(1.2)	1.0	0.50	0.50	1.00	1.00	32.0	32.5
Latin America	(7.6)	3.9	8.3	7.0	6.24	5.55	5.80	6.43	-	-
Argentina	(9.5)	3.5	50.0	40.0	35.00	30.00	0.00	0.00	75.0	80.0
Brazil	(5.0)	3.0	2.0	3.6	2.00	2.50	6.80	7.50	5.25	5.00
Chile	(6.6)	5.1	2.7	2.0	0.50	0.75	2.50	3.00	800	775
Colombia	(6.5)	6.0	1.8	2.5	1.50	2.00	5.50	6.00	3,750	4,000
Mexico	(10.3)	3.6	4.2	3.2	4.00	4.00	5.50	6.25	21.3	21.8
EEMEA	(5.1)	3.8	4.9	5.2	4.31	4.54	6.66	6.47	-	-
Hungary	(5.7)	5.4	2.7	3.3	0.60	0.75	1.90	2.30	350	330
Poland	(4.5)	5.5	2.8	3.1	0.10	0.10	1.20	1.65	4.40	4.30
Russia	(4.9)	2.9	3.3	3.8	4.00	4.00	6.20	5.90	76.0	71.0
South Africa	(8.0)	2.7	3.4	3.9	3.50	4.00	9.20	9.50	17.0	17.8
Turkey	(4.2)	3.9	11.3	11.7	10.25	11.50	13.00	12.50	8.00	7.60

Growth and inflation forecasts are calendar year averages.
Interest rate and FX rates are year end forecasts.
Long rates are 10-year yields unless otherwise indicated.
The long rates aggregate excludes Argentina; Argentina is not forecasted due to distortions in the local financial market.
Real growth aggregates represent 31 country forecasts not all of which are shown

Contributors

Armando Armenta armando.armenta@alliancebernstein.com	Adriaan Du Toit adriaan.dutoit@alliancebernstein.com	Darren Williams darren.williams@alliancebernstein.com
Guy Bruten guy.bruten@alliancebernstein.com	Mo Ji mo.ji@alliancebernstein.com	Eric Winograd eric.winograd@alliancebernstein.com
Katrina Butt katrina.butt@alliancebernstein.com	Markus Schneider markus.schneider@alliancebernstein.com	