

# GLOBAL MACRO OUTLOOK

DECEMBER 2020

## KEY FORECAST TRENDS

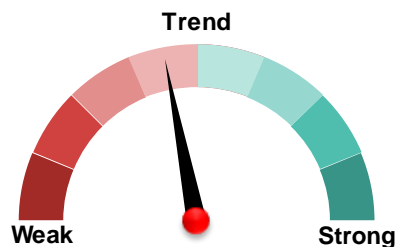
- + The imminent rollout of COVID-19 vaccines has made it more likely that economic life will soon return to some version of “normality.” After a difficult winter, we expect global growth to pick up quite strongly next year.
- + We caution against thinking this marks a durable improvement in the longer-term outlook. The global economy faced structural headwinds prior to COVID-19, and the intervention of a global pandemic is unlikely to have improved things.
- + Still, the near-term outlook has brightened. The question now is whether stronger growth will lead to a more broad-based reflation in consumer prices and bond yields.
- + The pieces are finally falling into place for the shift to a higher inflationary regime. But with the US dragging its heels on fiscal policy, output gaps widening and inflation expectations dormant, it’s hard to see this happening in 2021.
- + The main aim of monetary policy in recent months has been to facilitate fiscal policy by keeping bond yields low. This new regime will be tested as growth recovers.
- + Yields are unlikely to rise much in Europe or Japan. But the US market has not yet internalized the possibility that current yield levels might be “normal,” making the outlook for US yields less certain.
- + With the US Federal Reserve (the Fed) keen to drive inflation higher, it is unlikely to react to stronger growth the way it has in the past. That doesn’t mean yields won’t rise at all, but a return to precrisis trading ranges is unlikely.

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## THE GLOBAL CYCLE

### ECONOMIC ACTIVITY



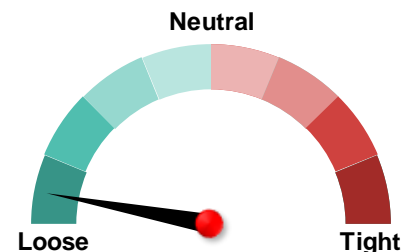
- + After a difficult end to 2020, growth is set to rebound strongly next year.
- + But a full recovery will take time. For many advanced economies, output may not return to precrisis levels until well into 2022.

### INFLATION



- + Elevated debt and a shift in the policy regime point to higher inflation medium term.
- + But large output gaps and dormant inflation expectations mean this is unlikely to happen in 2021.

### MONETARY POLICY



- + Advanced-economy policy rates are likely to remain on hold next year and probably well beyond.
- + Central banks are likely to push back against anything other than a modest rise in bond yields.

# GLOBAL FORECAST

## FORECAST OVERVIEW

### Key Assumptions

- + **Virus:** likely to weigh on growth near term, then fade as a cyclical factor
- + **Vaccine:** effective vaccine an important part of this process, but won't allow an immediate return to business as usual
- + **Fiscal policy:** should remain highly supportive at the global level; US outlook less certain
- + **Monetary policy:** central banks to keep policy rates anchored and bond yields low
- + **Secular backdrop:** headwinds

### Central Forecast

- + **Global growth:** after a difficult winter, global growth likely to rebound quite strongly
- + **Reflation:** COVID-19 scarring to prevent a return to precrisis trend
- + **Inflation:** regime shift firmly underway, but inflation set to remain muted during 2021
- + **Yields:** upward pressure will build as growth recovers, but any increase likely to be modest
- + **USD:** relative growth prospects point to a weaker dollar

### Upside Risks

- + Very rapid vaccine rollout
- + More aggressive stimulus
- + Limited COVID-19 scarring

### Downside Risks

- + Virus continues to spread
- + Rising US bond yields
- + Accidental/premature austerity

### Core Views

- + Yields to remain very low
- + Stronger euro vs. the US dollar
- + Prefer hard-currency EM debt

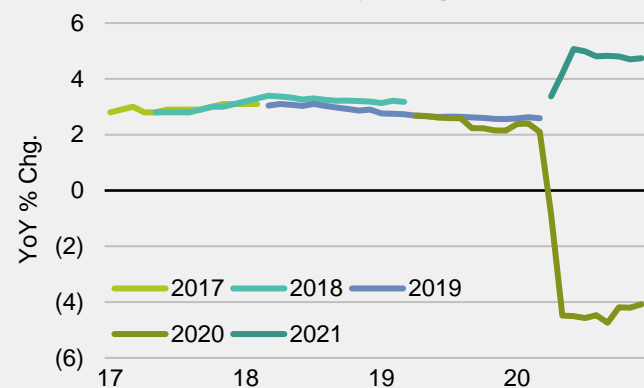
## AB Growth & Inflation Forecasts (%)

	Real GDP Growth		CPI Inflation	
	2020	2021	2020	2021
<b>US</b>	(3.6)	3.5	1.3	2.0
<b>Euro Area</b>	(7.3)	4.0	0.3	0.7
<b>Japan</b>	(5.3)	2.6	0.2	0.3
<b>China</b>	2.0	8.0	2.5	2.3
<b>Global</b>	<b>(4.1)</b>	<b>4.7</b>	<b>2.0</b>	<b>2.2</b>
<b>Industrial Countries</b>	(5.3)	3.5	0.8	1.4
<b>Emerging Countries</b>	(2.3)	6.6	3.8	3.3
<b>EM ex China</b>	(5.7)	5.3	4.9	4.4

As of November 30, 2020  
Source: AB

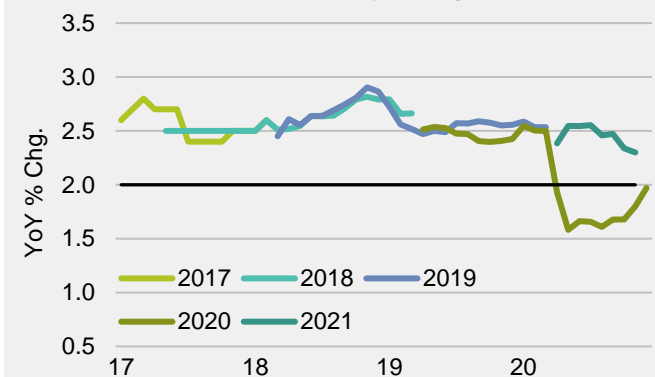
## FORECASTS THROUGH TIME

### 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 November 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 November 30, 2020  
Source: AB

## GLOBAL MARKET OUTLOOK: YIELD CURVES

### GLOBAL YIELDS

**Global**—The overriding objective for monetary policy this year has been to support fiscal policy by keeping bond yields low. This policy is likely to come under pressure as growth recovers, but central banks are unlikely to tolerate anything other than a modest increase in bond yields.

**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 support the economic recovery by continuing to purchase US Treasuries and preventing rates from moving materially higher.

**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 programme in December, placing a cap on core and peripheral bond yields.

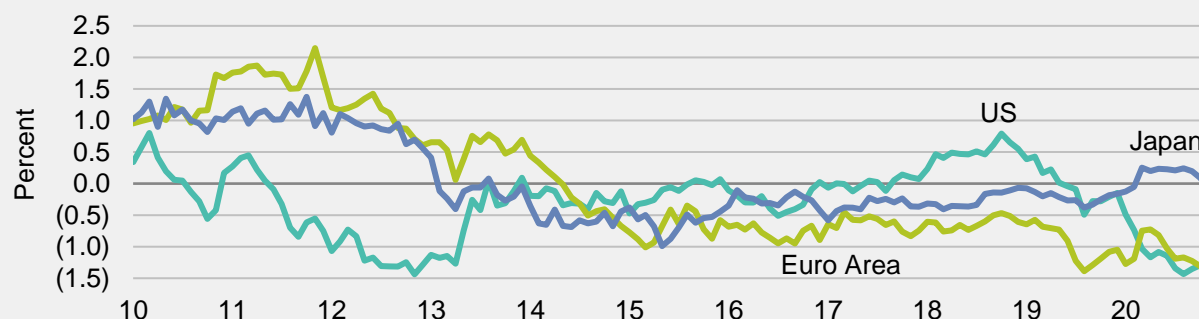
**Japan**—Tweaks from the Bank of Japan (BOJ)—dropping the Y80 trillion per annum purchase target—largely validate the status quo. Yield-curve control (YCC) should anchor 10-year bond yields close to zero for the foreseeable future.

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

	AB		Consensus	
	2020	2021	2020	2021
<b>US</b>	0.75	1.25	0.85	1.20
<b>Euro Area</b>	(0.50)	(0.25)	(0.52)	(0.29)
<b>Japan</b>	0.00	0.00	0.01	0.05
<b>China</b>	3.30	3.50	3.16	3.09

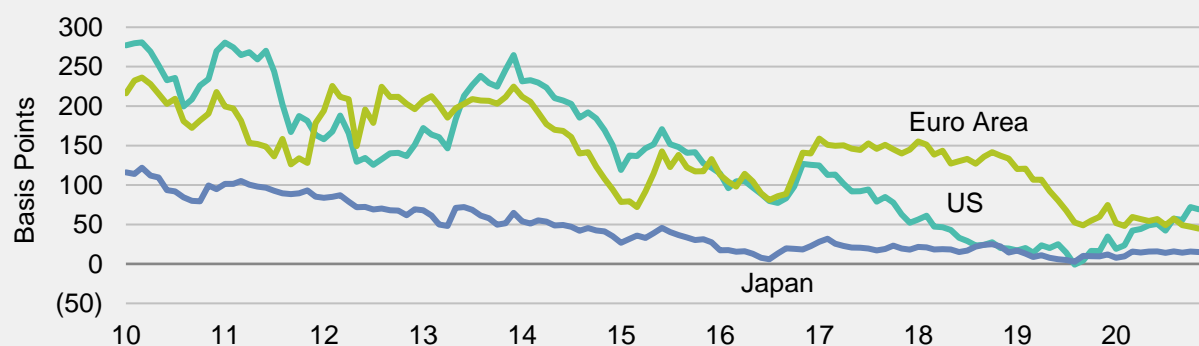
As of November 30, 2020  
Source: Bloomberg and AB

#### Real 10-Year Bond Yields\*



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

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



Through November 30, 2020  
Source: Bloomberg and AB

## GLOBAL MARKET OUTLOOK: CURRENCIES

### FX FORECASTS

**USD**—The Fed’s efforts to boost inflation expectations have 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 strengthened in recent weeks and is now at its highest level in almost two years against the US dollar. The euro’s gains on a trade-weighted basis have, however, been more muted and this may help explain why the European Central Bank has not so far responded (verbally) to the move.

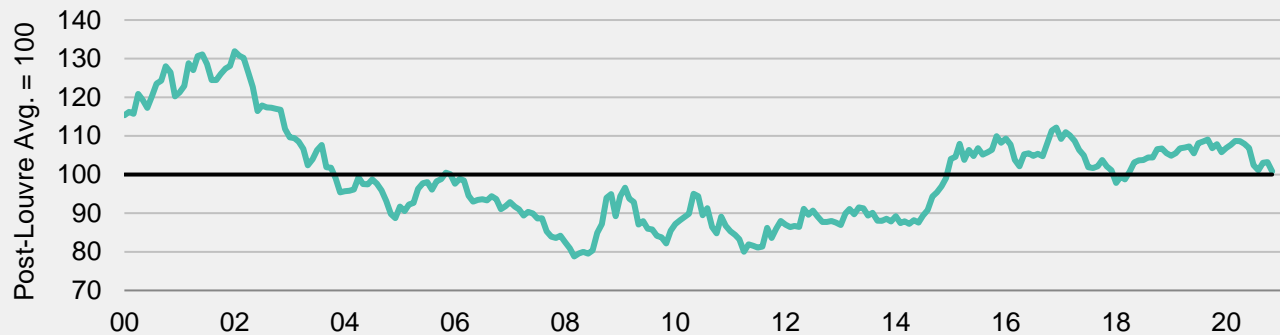
**JPY**—We see few Japan-specific reasons for a big shift in the yen. Policies in developed economies have converged with those in Japan. That said, we still think the yen retains its risk-off characteristics.

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

	AB		Consensus	
	2020	2021	2020	2021
EUR/USD	1.25	1.30	1.19	1.23
USD/JPY	104	101	104	104
USD/CNY	6.50	6.30	6.70	6.50
EUR/GBP	0.95	0.95	0.90	0.90

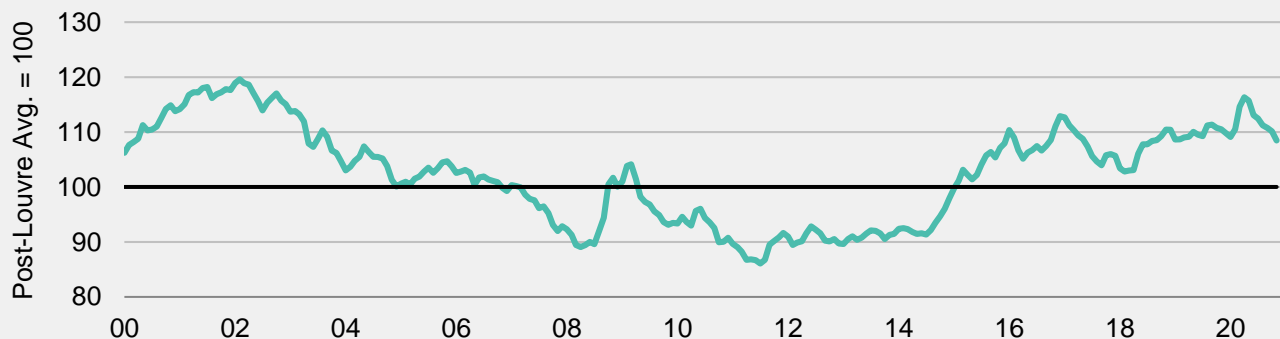
As of November 30, 2020  
Source: Bloomberg and AB

**Nominal USD Exchange Rate: US Dollar Index**



Through November 30, 2020  
Source: Bloomberg and AB

**Real USD Broad Trade-Weighted Exchange Rate**



Through November 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	(3.6)	3.5	1.3	2.0	0.13	0.15	0.75	1.25

### OUTLOOK

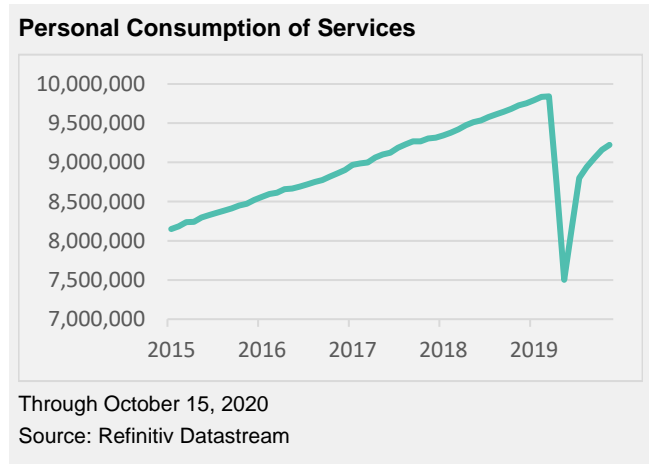
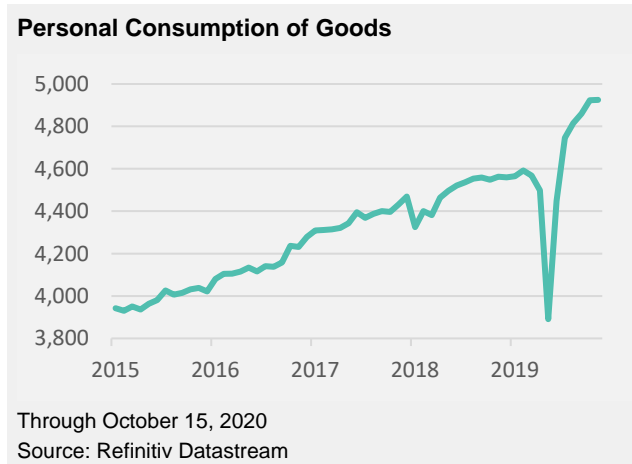
- + With the election behind us and vaccines on the horizon, the major uncertainties that plagued the economy in 2020 are likely to fade in the coming months, paving the way for a significant improvement in growth. Indeed, we forecast GDP to rise at roughly twice our estimate of the economy's steady-state potential.
- + That expansion will be supported by monetary policy, with the Fed much more likely to ease further than tighten in 2021. The central bank remains concerned about potential scarring from the COVID-19 crisis, as well as long-term secular headwinds to growth. We share those concerns but think they are more likely to manifest themselves in 2022 and beyond than in 2021.
- + Fiscal policy remains unclear, with the election result sharply reducing the size of any near-term stimulus and reducing the probability of long-term fiscal support for growth.

### RISK FACTORS

- + To be sure, COVID-19 is not yet in the rear-view mirror, and the next few months are likely to be very difficult from both public health and economic perspectives. Should the rollout of vaccines or their efficacy go less smoothly than anticipated, our above-trend growth forecasts would be too optimistic.
- + Because inflation is measured in year-over-year (YoY) terms, it will very likely move above the Fed's 2.0% target in the middle of next year. If financial markets respond to that increase by pushing interest rates sharply higher, it could materially slow the recovery.

### OVERVIEW

After several quarters with very limited visibility into the future, a completed election and the appearance of near-term medical innovations have made the outlook clearer. We believe that 2021 looks set to be a very good year for growth, with the US economy poised to expand at roughly twice its steady-state rate, assuming the vaccines allow for a broader reopening and improved confidence. Fiscal support would help to bridge the remaining gap, but however sunny next summer looks, the winter before it will be very dark. Prospects for meaningful fiscal support have diminished with a likely divided government in Washington and this will reduce the economy's lift-off velocity later next year. We remain concerned that structural headwinds, including rising debt, increasing political polarization driven by populism, and deteriorating demographic trends will weigh on long-term growth. Moreover, the absence of durable fiscal support makes it less likely that the economy will sustainably break out of the low-growth, low-inflation rut it has been in for more than a decade. That is more likely the story for 2022 and beyond, however. In 2021, the reopening of the economy and accommodative monetary policy should generate strong growth, led by the services sector, which has been disproportionately impacted by the COVID-19 crisis.



## 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
<b>Euro Area</b>	(7.3)	4.0	0.3	0.7	(0.50)	(0.50)	(0.50)	(0.25)	1.25	1.30

### OUTLOOK

- + Although recent vaccine news has raised hopes that there's light at the end of the COVID-19 tunnel, the euro area still faces a difficult winter. The good news is that restrictions on economic and social activity are helping to bring the virus under control. The bad news is that these restrictions are likely to weigh on near-term output growth. Therefore, we expect a contraction of about 2.5% in the fourth quarter.
- + While it's possible that output will start to grow in the first quarter, it's like to be muted owing to a cautious approach to the removal of COVID-19 restrictions and the possibility of Brexit-related disruption. A more material rebound is likely set for the spring, especially if vaccines can be rolled out quickly.
- + The weak near-term outlook, persistent failure to generate inflation and an ongoing need to support fiscal policy could lead to another easing of monetary policy in December. Indeed, the European Central Bank (ECB) has already signaled as much. We expect a further expansion and extension of the PEPP Asset Purchase Programme—which should guarantee support for bond markets until at least the end of 2021—and an extension of more generous terms on lending to euro-area banks.

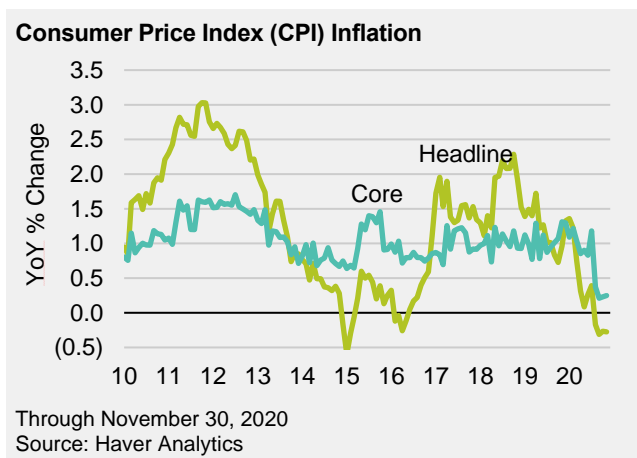
### RISK FACTORS

- + Our forecasts assume that restrictions on economic and social activity will, for the most part, fall on the relatively small hospitality and recreational activity sectors. We believe restrictions will be gradually relaxed during the first quarter and that this will mark the end of national lockdowns. If we're wrong, the recovery is likely to be more muted than expected.
- + There are also risks to the upside. We assume a relatively slow rollout of vaccines and gradual return to normality. Should vaccines be distributed more quickly and prove to be as effective as in clinical trials, a more rapid recovery is possible. The surprisingly strong rebound in third-quarter output also points in this direction.

### OVERVIEW

The composite Purchasing Managers' Index (PMI) fell to 45.3 in November from 50.0 in October, signaling a shift to contractionary territory for the euro-area economy. This was not, however, unexpected given the increasingly strict restrictions imposed in recent weeks and the PMI is still well above the unprecedented low of 13.6 it reached in April.

The November data also revealed some interesting splits, by country and sector. The manufacturing PMI, for example, held up well at 53.8, over 10 points higher than its services counterpart, which slumped to 41.7. Germany is always at a relative advantage when manufacturing is doing well and, currently, it's also benefiting from less stringent restrictions than in other large euro-area countries. The net result was a composite PMI of 51.7 in November, compared with 40.6 in France, 42.7 for Italy and 41.7 in Spain. It's also worth noting that the orders/inventories ratio in the German manufacturing PMI hit a record high of 1.56 in November.



# 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	2.5	2.3	4.35	4.10	3.30	3.50	6.50	6.30

## OUTLOOK

- + China's official GDP 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.
- + Economic recovery is on track, but it is still not normalized; hence continuous policy easing is expected.

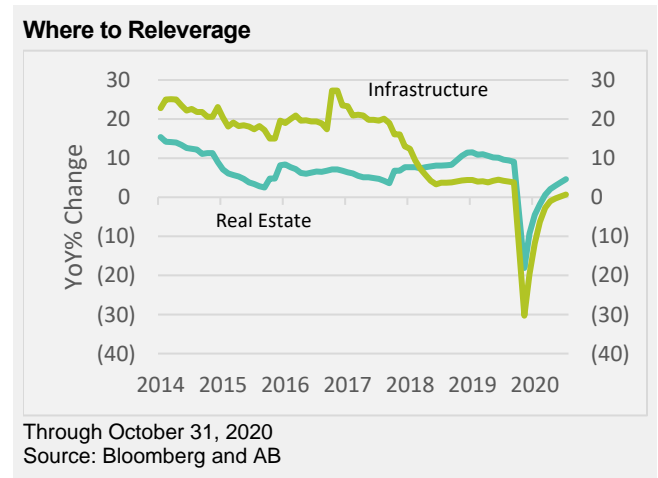
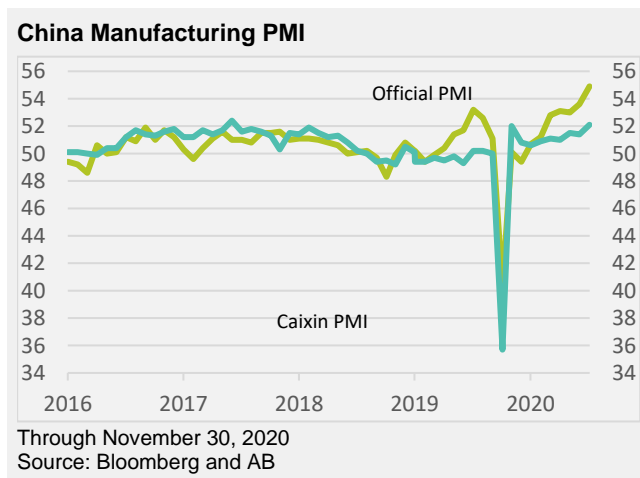
## RISK FACTORS

- + Policy easing may be less than expected if new economic data offer big surprises to the upside. This would put a sustained economic stabilization at risk for December and into next year.
- + With COVID-19 still a global pandemic, there will be renewed 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. Therefore, there are rising risks of potential policy tightening in December 2020 and the first quarter or first half of 2021. Tightening may happen in the following areas: 1. **Monetary tightening**—expectation is rising that the People's Bank of China (PBOC) may hike rates, though we expect the central bank will delay by providing just enough, but not too much, liquidity. 2. **Fiscal tightening**—special bond issuance for combating COVID-19 and additional special local government bond issuance, which accounts for about 3% of GDP, will end in 2020. 3. **Deleveraging**—strategy momentum will be extended, given recent local state-owned enterprise (SOE) defaults, and it will spill over to other sectors as well. 4. **Property tightening**—underway and maybe getting even tighter, given repeated comments by PBOC vice premier Liu He and China Banking and Insurance Regulatory Commission (CBIRC) chairman Guo Shuqing that property is for dwelling not speculating and for the first time depicting the sector as the biggest “grey rhino” in the system. This implies that the potential tightening is negative for China-related risk assets. In our view, China will have to accelerate its easing in the second half of 2021, given the tightening in the first half of the year.

Regarding China's view of its US relationship under a Biden administration, expectations are for more stability and predictability. 1) A more nuanced rivalry: competitors, not enemies. 2) The US “global reset” will take some pressure off the relationship. 3) US multilateralism will create constraints for China. 4) A more even-keeled US approach will help stability. 5) A less hawkish US approach will make life easier for China's tech companies. 6) China will not be an immediate priority for a Biden administration. 7) Escalation of trade tensions looks unlikely. The consensus reached by Chinese policymakers suggests that they are looking ahead to an easier relationship with the US in trade and economic matters. But given Biden's ambitions to refocus on the US's global leadership role, they also see the potential for a more challenging dialogue on security issues.



## Japan

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
<b>Japan</b>	(5.3)	2.6	0.2	0.3	(0.10)	(0.10)	0.00	0.00	104	101

### OUTLOOK

- + The new administration of PM Yoshihide Suga represents continuity from that of former PM Shinzo Abe and has few, if any, macro implications.
- + Monetary policy setting remains unchanged, with Yield Curve Control anchoring interest rates.
- + 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 additional economic squeeze.

### OVERVIEW

The third wave of Covid-19 continues to rise in Japan. Whilst still an order of magnitude below that experienced in the US, UK or Europe, cases are now well above the previous two waves, and confirmed new deaths have reached record highs in recent days. High-frequency mobility data have started to soften, some of the support measures (the “Go To” travel and eat programs) have been suspended, and residents are being encouraged to “refrain from going out as much as possible.” It’s highly likely that economic activity will soften as we head into year-end and 2021.

This is providing renewed impetus for more fiscal policy support via an additional supplementary budget. Once again, this will be facilitated by the “unlimited” bond buying by the BOJ. Japan remains at the forefront of fiscal-monetary cooperation—“joined-at-the-hip”—and there’s no indication it’s about to change. Accordingly, bond yields will remain anchored despite any additional supply.

The change in political leadership in Japan occurred smoothly, with cabinet secretary Suga taking over as prime minister (PM) from Abe, who resigned because of ill health. 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. Talk of a snap election has receded as Covid-19 cases continue to rise. It looks as if the next lower house elections will take place after July’s Tokyo Olympics.

## 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
<b>Australia</b>	(2.5)	2.5	0.7	1.5	0.10	0.10	0.85	0.80	0.74	0.75
<b>New Zealand</b>	(3.0)	5.1	1.6	1.4	0.25	(0.10)	0.65	0.65	0.70	0.70

### AUSTRALIA/NEW ZEALAND

- + The surge in COVID-19 cases in Australia through July and into early August—centered in the state of Victoria—has rapidly reversed thanks to stringent restrictions and state border closures. With new cases of community transmission now virtually eliminated, restriction relaxations and border openings will continue apace into year-end.
- + While the hit to activity from the lockdowns has been more modest than expected, and the recovery a little more robust, that has not stopped the Reserve Bank of Australia (RBA) from continuing to fret about the medium-term outlook. In early November it cut rates and implemented a US\$100 billion bond purchase program—focused on the five- to 10-year part of the yield curve—to supplement its three-year yield curve control target.
- + In New Zealand, the story is similar. COVID-19 has effectively been eliminated within the country. But restrictions on international travel and tourism will have to continue—a significant headwind for the economy going into 2021. The Reserve Bank of New Zealand (RBNZ) is set for more policy easing: it unveiled a funding-for-lending scheme in November and will still likely 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
<b>Canada</b>	(3.0)	3.3	0.5	2.0	0.25	0.25	0.75	1.00	1.28	1.24

### OUTLOOK

- + Canada's economy looks set to expand rapidly in 2021, as the bounce back from the COVID-19 crisis gains momentum. First, however, will come a long dark winter characterized by lockdowns designed to limit the spread of the virus until vaccines become available.
- + In an effort to limit the economic scarring caused by the pandemic, the Bank of Canada will remain accommodative across the forecast horizon.
- + We expect the Canadian dollar to appreciate modestly against the USD in 2021.

### RISK FACTORS

- + As with the global economy, COVID-19 remains the biggest risk until vaccines are distributed and public health improved.

### OVERVIEW

The winter will be long and dark, with COVID-19 still circulating and a vaccine on the horizon but not widely available until well into next year. A vaccine tomorrow does not help the economy very much today, and the longer the crisis lasts, the more likely it is that it will leave lasting scars on the economy. Nonetheless, brighter days are ahead, and once the public health situation improves, we expect the Canadian economy to benefit from an improving US and global growth outlook. For now, however, it is matter of waiting out the winter for better times to arrive.

## UK

	Real GDP (%)		Inflation (%)		Policy Rate (%)		10-Yr. Bond Yield (%)		FX Rates vs. USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
<b>UK</b>	(11.0)	3.5	0.8	1.6	0.10	0.10	0.25	0.50	1.30	1.35

### OUTLOOK

- + The UK has been hit hard by COVID-19, with third-quarter output still 9.7% below its level in the fourth quarter of last year. That's significantly bigger than shortfalls of 3.5% in the US and 4.4% in the euro area.
- + The near-term outlook is also poor, with recent restrictions imposed by the British government among the most stringent in Europe. Some disruption is also likely at the beginning of 2021 as the UK exits its Brexit transition deal. Output looks certain to contract in the fourth quarter and may well do the same in the first quarter of next year.
- + On a brighter note, the UK may well benefit from a relatively quick rollout of COVID-19 vaccines, partly because it has secured greater access to vaccines than other countries and also because it is fast-tracking regulatory approval—the Pfizer/BioNTech vaccine has been approved and the first inoculations are imminent.
- + Brexit is still 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. But the two sides may also fail to reach agreement, in which case 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 scale of this disruption will depend on the precise shape of the final settlement and on 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 factor shaping the outlook is the outcome of current trade negotiations with the EU. As things stand, we would not rate the chances of a deal much higher than 50%.

## 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	(5.7)	6.5	3.0	2.4	2.22	1.95	3.56	3.47	—	—
Hong Kong	(8.0)	5.0	0.9	0.8	1.00	0.90	0.70	0.90	7.75	7.77
India	(10.8)	9.3	7.5	4.5	3.75	3.25	5.80	5.70	74.00	72.00
Indonesia	(2.0)	6.0	2.2	2.3	3.75	3.25	6.10	5.90	14,100	13,900
South Korea	(0.8)	3.2	0.5	0.8	0.50	0.50	1.60	1.45	1,100	1,050
Thailand	(6.3)	5.2	(0.9)	1.1	0.50	0.50	1.35	1.35	30.3	31.50

### OUTLOOK

- + In general, the virus is contained in most countries across the region, but cases have picked up in South Korea and Malaysia.
- + 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. Singapore successfully contained a significant outbreak earlier in the year—thanks to limited lockdowns, testing and contact tracing. Cases in India, Indonesia and the Philippines remain elevated, but appear to have peaked. The main exception is Malaysia, where case numbers surged through October, leading to the re-imposition of the Conditional Movement Control Order (CMCO) restrictions. 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, initially tech-related but now across the board, have bounced sharply, and are 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 a 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 an explicit “burden-sharing” agreement between the finance ministry and the country’s central bank. And in the Philippines, the central bank provided substantial loans this year, an arrangement that will continue in 2021. To date, market concerns have been eased by commitment that these are “one-off” measures. 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
<b>Latin America</b>	<b>(7.1)</b>	<b>4.1</b>	<b>8.1</b>	<b>7.3</b>	<b>6.32</b>	<b>5.49</b>	<b>6.37</b>	<b>5.89</b>	<b>—</b>	<b>—</b>
Argentina	(11.0)	4.0	45.0	40.0	35.00	30.00	—	—	90.00	120.00
Brazil	(4.)	3.0	3.0	3.6	2.00	2.50	7.80	7.00	5.25	5.00
Chile	(6.6)	5.1	3.0	2.5	0.50	0.75	2.50	3.00	760	775
Colombia	(6.5)	5.0	3.0	2.5	1.75	1.75	5.50	5.50	3,750	4,000
Mexico	(8.8)	4.5	3.6	3.5	4.25	3.50	5.75	5.50	20.7	21.50

### OUTLOOK

- + Growth in Latin America is recovering more slowly than elsewhere in emerging markets. Next year, structurally low growth in Brazil and unfriendly business conditions in Argentina will weigh on the regional GDP growth aggregate.
- + Rising debt levels across the region will necessitate a faster removal of fiscal stimulus in 2021. However, low inflation despite the strong currency depreciation will allow monetary stimulus to remain ample next year. Most of next year's improvement in activity will need to come from external demand and a recovery in private investment.

### RISK FACTORS

- + A resurgence of the virus and renewed lockdowns in cities across the region would slow the economic recovery and create pressure for governments to extend fiscal stimulus.

### OVERVIEW

In Brazil, fiscal policy remains the key risk into 2021. While the government and congressional leaders are committed to maintaining the spending cap, uncertainty in the market is keeping risk premiums high and the yield curve steep. We expect the government to remain committed to its fiscal rules, with limited deviations from agreed-upon fiscal targets for 2021, which will allow the central bank to keep the policy rate accommodative for much of the year. The V-shaped recovery has continued in Brazil, with third-quarter GDP increasing 7.7% quarter on quarter, driven by strong private consumption and further contraction in imports. We upgraded our 2020 GDP growth forecast to -4.25% to reflect the faster-than-expected recovery. Activity into 2021 will continue to improve, but at a slower pace.

Activity in Mexico has continued to recover, buoyed by a strong external sector. While investment demand remains weak and private consumption is stabilizing, exports are up relative to the previous year, driven by a strong recovery in manufacturing exports and a stabilization in the widening of the non-oil trade deficit. PMI data all point to a stable recovery in the fourth quarter. We have improved our 2021 real GDP growth forecast to 4.5% on the back of a stronger recovery in domestic demand next year. Moreover, the recent appreciation of the Mexican peso will keep muted inflationary pressures stemming from food prices and permit around a 0.75% cut in the intervention rate next year. All eyes will remain on how much the fiscal outlook has deteriorated in 2020, but fiscal slippage will be contained as the government has refrained from delivering a strong stimulus.

In Peru, the pervasive political crisis resurfaced in November as a second attempt to impeach President Martin Vizcarra was successful and removed him from his position. The head of Congress, Manuel Merino, who also led the impeachment procedure, was sworn in as president. But owing to violent protests, he was forced to resign after three days. Francisco Sagasti, a moderate Congress member, assumed the presidency after intense negotiations. He reaffirmed the call for April general elections, and to moderate the political clashes between Congress and the executive power in the interim. A more lasting solution to the recent turmoil would entail the new president being chosen with a clear mandate and sufficient Congress representation. Despite the political turmoil, Peru's strong balance sheet and record of orthodox policies implied only minor disruptions in asset prices.

## 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
<b>EEMEA</b>	<b>(4.5)</b>	<b>3.9</b>	<b>4.9</b>	<b>5.1</b>	<b>5.32</b>	<b>4.33</b>	<b>6.36</b>	<b>6.37</b>	<b>—</b>	<b>—</b>
Hungary	(5.7)	5.4	2.9	3.2	0.60	0.75	1.90	2.20	350	330
Poland	(4.5)	5.5	3.1	2.8	0.10	0.10	1.20	1.50	4.40	4.30
Russia	(4.9)	2.9	3.3	3.8	4.00	4.00	6.00	5.90	74.5	70.5
South Africa	(8.0)	2.7	3.2	3.5	3.50	3.50	9.20	9.50	15.0	15.5
Turkey	(1.5)	4.3	11.3	11.7	15.00	11.00	12.00	12.50	7.80	8.10

### OUTLOOK

- + Real growth is likely to be weak in the last quarter of 2020, as renewed lockdown measures are likely to weigh on activity in several EEMEA countries. Prospects of a successful vaccine will help the recovery to gather pace as we enter 2021, although output will remain below pre-pandemic levels.
- + 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

- + Despite prospects of a successful vaccine, the shape of the recovery beyond 2020 remains uncertain, especially in terms of the speed and success of vaccine distribution, as well as labor markets' ability to absorb high levels of unemployment. Normalization of international travel and a revival of the tourism industry will also remain an important risk factors for countries such as Turkey.

### OVERVIEW

Turkey continued to be the center of attention in November, as the country's currency crisis prompted President Recep Tayyip Erdogan to make significant personnel changes at the central bank (CBRT) and finance ministry at the beginning of the month. This was followed by a 4.75% hike to 15.0% in the policy rate and a simplification of the interest-rate corridor, instilling some much-needed confidence that the central bank is returning to a more orthodox policy framework. Real rates of around 2.0% are still meaningfully lower than those we saw during the late 2018/2019 period, but combined with renewed policy rate orthodoxy, they can be a contributing factor towards rebuilding domestic confidence, with a positive impact on dollarization and the import of gold. Depending on foreign exchange strength during the remainder of December, the CBRT may have to implement further tightening based on the latest inflation and trade data. The risk remains that the CBRT will not have the political maneuvering room to implement the necessary additional tightening.

Interest-rate hikes and an accompanying simplification process can have a positive impact on sentiment. But the overall impact on the balance of payments and likely limited ability to bring about a sustainable turnaround in the USD outflows, suggest that Turkey's macroeconomic vulnerabilities—especially with regards to (net) reserve levels—will remain in place. Significant private sector external debt repayments against likely ongoing low rollover ratios will continue to lead to significant capital outflows, which may not be covered by an expected turnaround in portfolio investments. It could also lead to an expected improvement in the current account deficit to around 1% of GDP in 2021, from 4% in 2020. In this context, we believe the CBRT will have difficulty accumulating foreign reserves in any meaningful manner to replenish its very weak net foreign asset position. This will continue to pose important risks in the event of renewed shocks, especially on the geopolitical front, such as potential US CAATSA sanctions and the Halkbank case pending in US courts.

## Frontier Markets

In Sri Lanka, the government tabled in November the 2021 budget, which lacked credibility in several aspects. First, the budget actually earmarked an increase in the nominal deficit to 8.9% of GDP next year, while the market had been expecting some fiscal consolidation next year to address debt sustainability concerns. Finance Minister Mahinda Rajapaksa highlighted that public investment would constitute the center piece of Sri Lanka's growth-led recovery in 2021 and he will pursue this as a priority. It remains to be seen if it is an expenditure item that the government is willing to cut back again when financing constraints emerge. Second, on the financing side, gross external sources appear overly optimistic, while local bond markets are expected to absorb net issuance of US\$5.9 billion in 2021. It is likely the central bank would have to get more involved in deficit financing. All in all, the gap between the government and the IMF remains significant, which decreases the likelihood of an orderly restructuring exercise in the context of an IMF-sponsored program anytime soon. Given question marks over forthcoming bilateral support and no access to external markets, this will lead to continued government debt increases and reserve depletion, which increases the risk that a more significant restructuring towards the end of 2021 will be required.

The International Monetary Fund (IMF) has been influential in providing emergency financial support to many countries in emerging markets in the wake of the COVID-19 crisis. But the emergency loan size is capped at 100% of the country's quota at the IMF, which wasn't enough for some countries that were facing preexisting debt sustainability pressures. This is the case in Costa Rica. The Costa Rican authorities had stated their intentions to pursue an IMF program in October, but were planning to engage with domestic stakeholders to decide on a consensual fiscal adjustment plan prior to negotiating with the IMF. These discussions were faced with severe resistance from opposition groups in Congress and civil groups, which took to the streets. After weeks of negotiations, an adjustment package was agreed upon, representing an adjustment of 3.14% of GDP over the next three years. However, much of the adjustment includes one-offs and temporary measures, which fail to meaningfully improve the debt trajectory. In our view additional measures are necessary, possibly including a local debt restructuring. The authorities will now negotiate with the IMF.

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