ALLIANCEBERNSTEIN

GLOBAL ECONOMIC RESEARCH

GLOBAL MACRO OUTLOOK

JULY 2020

KEY FORECAST TRENDS

- Activity has bounced as governments relax restrictions on economic and social activity. There's even increased talk of a "V-shaped" recovery.
- We think this is misplaced. Given the unprecedented restrictions placed on activity, growth was always going to rebound strongly as countries emerged from lockdown.
- But the level of output is still well below "normal" and closing the gap won't be easy, particularly as restrictions on some forms of business activity are here to stay.
- Renewed virus outbreaks look inevitable. And while few countries are unlikely to shut down their economies again, even local lockdowns are likely to be disruptive.
- The overall shape of recovery is therefore likely to be slow and uneven rather than "V-shaped." Key challenges lie ahead, including the US election and rising tension between China and the West.
- The case for additional fiscal stimulus remains compelling. The good news is that most governments are likely to deliver—even in Europe, austerity is over.
- Direct monetary stimulus has reached the end of the road. But central banks still have a key role to play by suppressing interest rates and facilitating fiscal expansion.
- It's a short step, though, from "joined-at-the-hip" monetary/fiscal policy to outright fiscal dominance—central bank "burden sharing" in Indonesia being a good example of this. History suggests this has rarely ended well.

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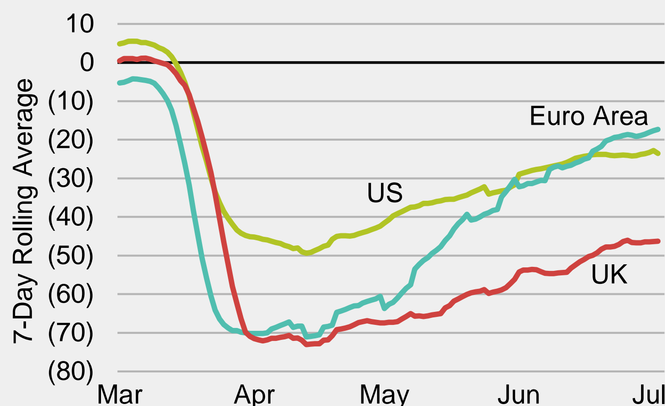
Virus Management Matters

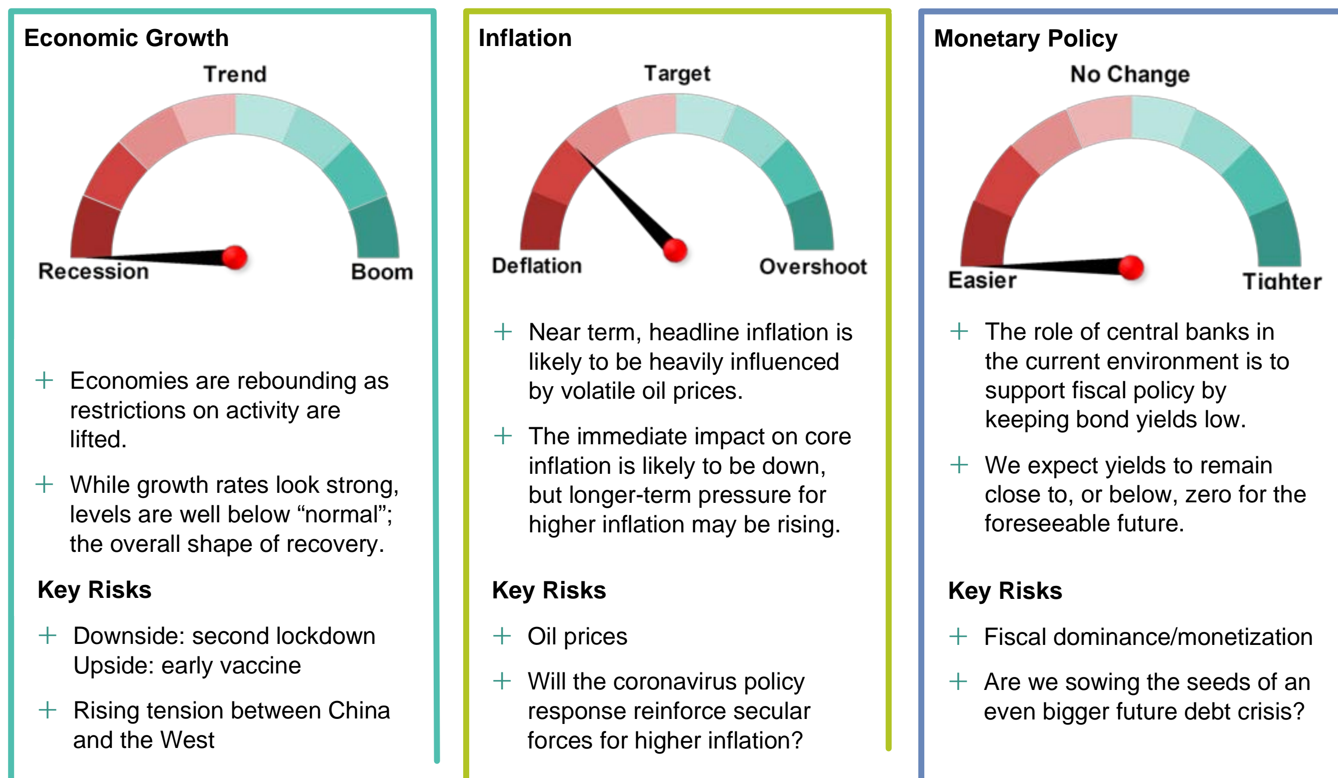
Google Mobility Trends[1]



As of July 3, 2020
[1]Average reading for retail & recreation, transit and workplace
Source: Google

- Countries have tackled COVID-19 in different ways. Most European countries quickly imposed national lockdowns while the US adopted a more piecemeal approach.
- This meant the initial hit to output was more modest in the US. But mobility indicators suggest that this advantage might now be fading as economies reopen more smoothly in the euro area.
- The UK looks worst placed of all, with an uncertain exit strategy and mixed messaging compounding errors made earlier in the crisis.

GLOBAL FORECASTS



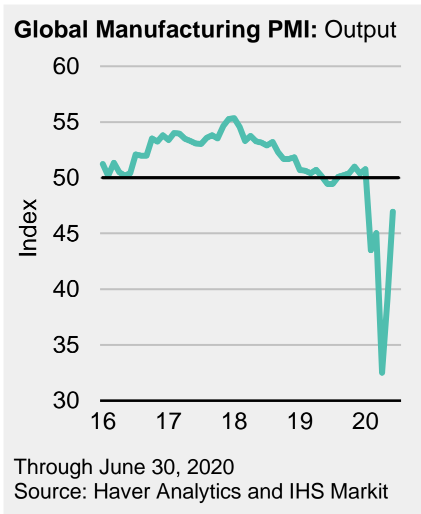
OUTLOOK

+ Recent data suggest that our COVID-19 roadmap is largely on track. We have left our global growth forecast little changed at –4.7% this year and +5.0% in 2021. Risks to this forecast appear evenly balanced. Some recent data have been very strong, suggesting that economies may be recovering more quickly than expected. But this was always likely to be the case as economies reopened from unprecedented lockdowns and many hurdles lie ahead, not least from further virus outbreaks.

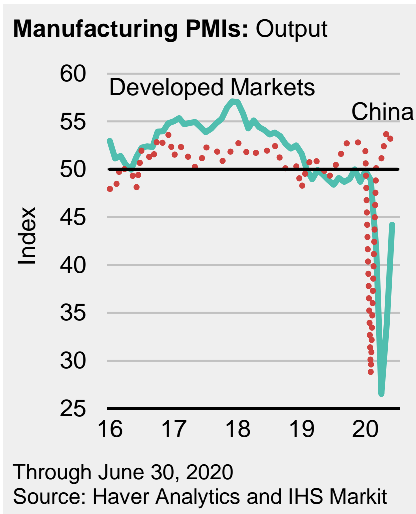
+ The biggest falls in output this year are likely in Europe, where we expect both the euro area and the UK to contract by roughly 10%. But this is mainly due to the speed and severity of the European lockdowns and the flipside of this is that the virus now seems to be largely under control. This, in turn, is allowing most European economies to reopen at a relatively rapid pace, particularly in contrast to the more hesitant progress in the US.

+ There is little scope for central banks to provide direct policy support. But they can support fiscal policy by suppressing bond yields and keeping debt-servicing costs low. Interest rates are unlikely to rise much, if at all, in coming quarters.

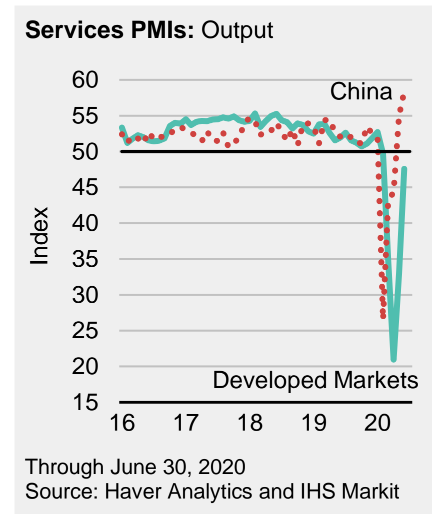
Global Cyclical Outlook: The Great Reopening



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



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



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

GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

Global—One of the main legacies of COVID-19 will be a huge increase in government debt, particularly in developed economies. This might normally be expected to put upward pressure on bond yields, but massive central bank bond purchases have helped to suppress yields. Implicit or explicit yield curve control is likely to be a permanent feature.

US—The Federal Reserve has committed to buying Treasuries on an open-ended basis and expects to keep the policy interest rate low across the forecast horizon. While we expect debt issuance to increase, this massive backstop from the Fed should keep yields low for the foreseeable future.

Euro Area—The European Central Bank (ECB) has extended and expanded its asset purchase program and is likely to place an effective cap on core and peripheral bond yields for some time to come.

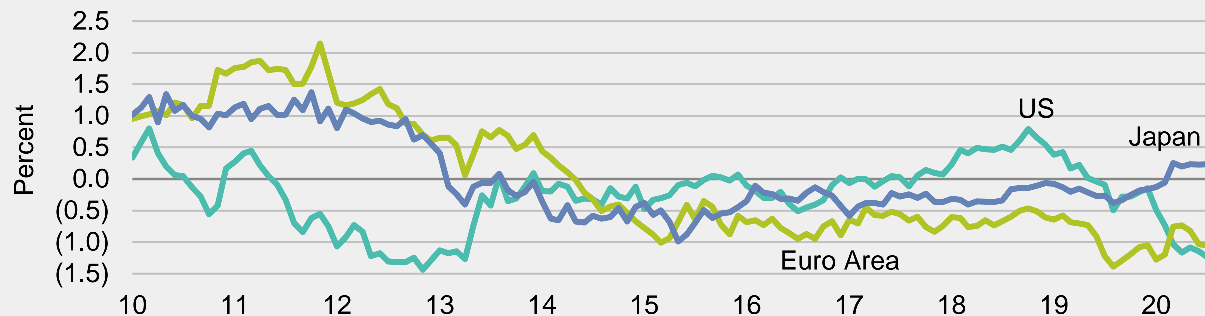
Japan—Tweaks from the Bank of Japan (BOJ)—dropping the Y80 trillion per annum purchase target—largely validate the status quo. Yield-curve control (YCC) should anchor 10-year yields close to zero for the foreseeable future.

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

	AB		Consensus	
	2020	**2021**	**2020**	**2021**
US	0.50	1.00	0.94	1.34
Euro Area	(0.50)	(0.25)	(0.38)	(0.14)
Japan	0.00	0.00	(0.02)	(0.02)
China	2.30	2.50	2.70	2.88

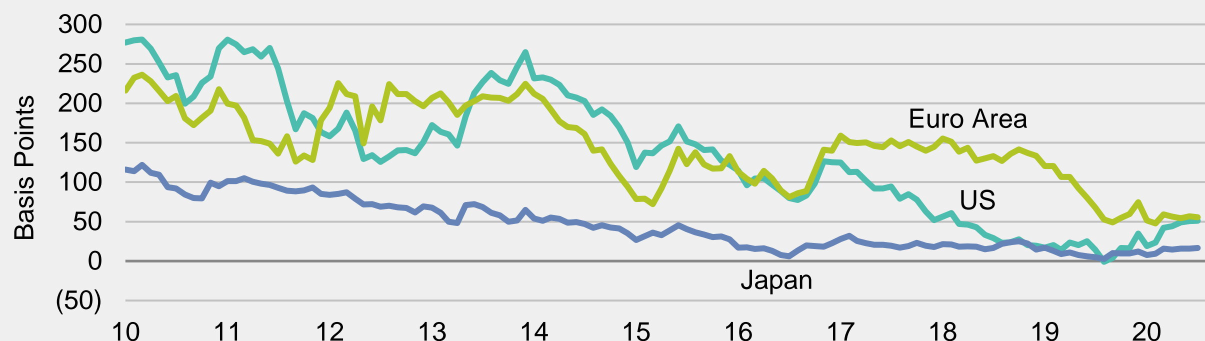
As of July 6, 2020
Source: Bloomberg and AB

Real 10-Year Bond Yields*



*Current 10-year bond yield less five-year/five-year-forward inflation swap
Through July 6, 2020
Source: Bloomberg and AB

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



Through July 6, 2020
Source: Bloomberg and AB

GLOBAL MARKET OUTLOOK: CURRENCIES

FX FORECASTS

USD—After initially strengthening in the early stages of the crisis, the USD has given back most of its gains as risk appetite has returned to financial markets. The deterioration in the US public health outlook relative to other developed markets may pose a threat to the USD in the coming weeks, though the USD will continue to benefit as the world's reserve currency.

EUR—Europe has handled the COVID-19 crisis relatively well and activity is now gaining pace across the region. The policy outlook has also brightened, with ECB bond purchases and the European Commission's Recovery Fund ensuring that all countries should be able to use fiscal policy to support their economies as they begin to recover. We do not anticipate a major EUR move in either direction, but near-term risks are probably skewed to the upside.

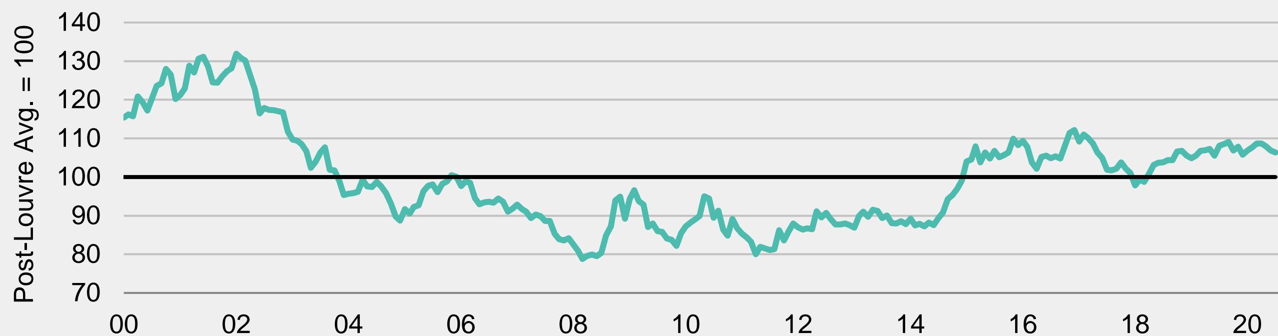
JPY—We see few Japan-specific reasons for a big shift in the yen. Policies in developed economies have converged with those in Japan. That said, we continue to think the yen retains its risk-off characteristics.

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

	AB		Consensus	
	2020	**2021**	**2020**	**2021**
EUR/USD	1.13	1.13	1.14	1.17
USD/JPY	105	105	107	107
USD/CNY	7.10	7.10	7.05	6.90
EUR/GBP	0.94	0.90	0.90	0.88

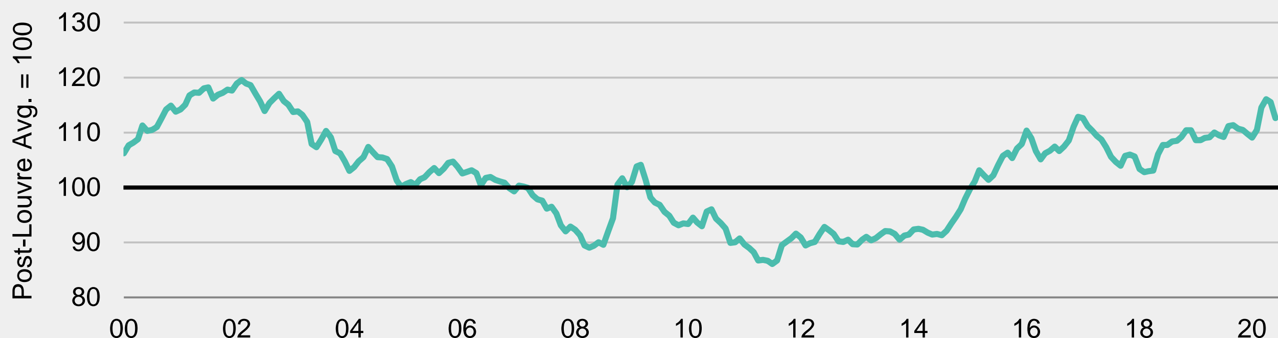
As of July 6, 2020
Source: Bloomberg and AB

Nominal USD Exchange Rate: US Dollar Index



Through July 6, 2020
Source: Bloomberg and AB

Real USD Broad Trade-Weighted Exchange Rate



Through June 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	(4.3)	4.0	0.5	2.5	0.13	0.13	0.50	1.00

OUTLOOK

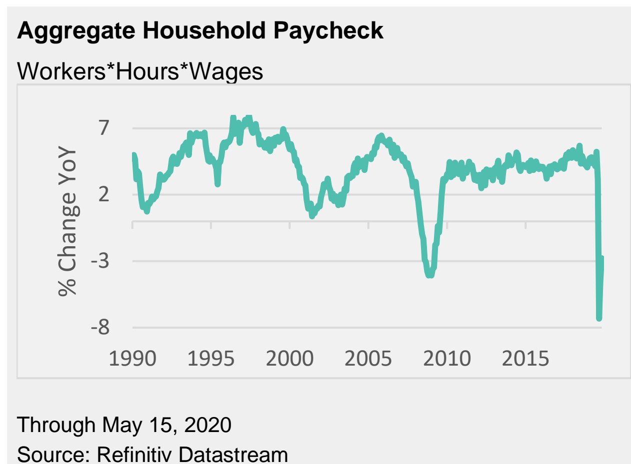
- As expected, once the US economy exited widespread lockdowns, activity appears to have bounced back quickly. Our view remains that the bounce back will be incomplete, however, with activity likely to be suppressed for several quarters to come as the pace of the rebound slows.
- With the resurgence of the COVID-19 virus in large parts of the country leading some states and regions to slow the pace of reopening, our expectation of slower growth to come has been reinforced.
- We believe that additional fiscal stimulus is critical to sustaining the recovery. Without more spending, household incomes will collapse in the second half of the year, pushing the economy back to the brink. The risk of political gridlock is rising as the election approaches, and if elected officials are unable to provide the needed support, the economic outlook will deteriorate significantly.

RISK FACTORS

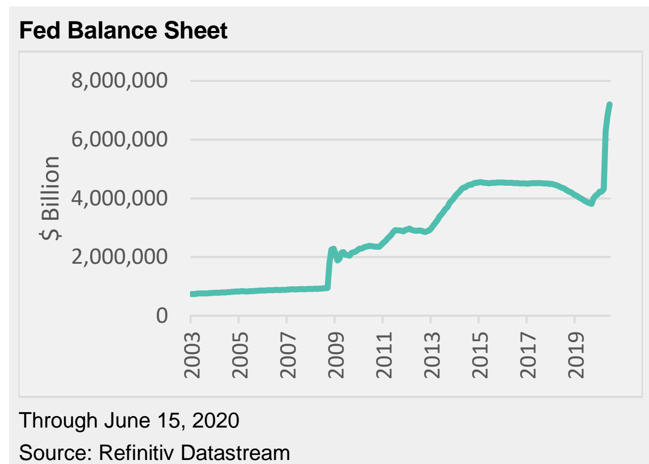
- Rising COVID-19 cases in many states show that the policy response to the public health crisis in the US has been poor compared with other countries. With reopening slowing and consumer behavior changing in the face of renewed infections, the US economy may lag behind those with a more effective public health response.
- Financial market performance has diverged from real economic performance and the economic outlook. That increases the probability of financial market volatility in the coming months.

OVERVIEW

The initial stages of the economic reopening went more or less as expected, if perhaps a couple of weeks sooner than we might have thought. A quick bounce off the bottom has made incoming economic data look quite good in relative terms, though in absolute terms the level of activity remains deeply depressed. We think the path from here is much rockier, however. Because the public health policy response in the US has been poor, the virus is more likely to be a persistent headwind to activity in the US than elsewhere, and the recent renewed shutdowns and travel restrictions in some locations are both evidence to support that view and a harbinger of things to come. Even if the virus is once again brought under control, there is a massive gap in household income that threatens the outlook. For now, government stimulus programs have bridged that gap. But more needs to be done: there are more than 15 million people out of work and even the most optimistic scenarios make clear that it will be several quarters before the economy can thrive without additional support. The Fed has done what it can, and it will continue to keep rates low and its balance sheet expanding. But it is really up to fiscal authorities to provide the needed help to households.



Through May 15, 2020
Source: Refinitiv Datastream



Through June 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	(10.0)	5.0	0.5	1.2	(0.50)	(0.50)	(0.50)	(0.25)	1.13	1.13

OUTLOOK

- Recent developments have been encouraging. COVID-19 is circulating at a much slower pace and appears to be largely under control. While the risk of secondary national lockdowns has not been eliminated, future outbreaks are more likely to be controlled through targeted local lockdowns and test and trace initiatives.
- With the virus largely under control, economies are starting to reopen and activity is coming back on-line. While this was led initially by Germany and other northern European countries, Italy and Spain are now picking up the pace.
- The good news is not confined to the handling of the virus itself. The euro area's monetary and fiscal policy response has exceeded even the most optimistic expectations at the beginning of the crisis, in stark contrast to previous crises.
- It's important, though, to maintain a sense of perspective. While many indicators are exhibiting very strong growth rates as economies are freed from lockdown, activity levels remain far short of normal and will require ongoing monetary and fiscal policy support. We are increasingly confident that this will be provided.

RISK FACTORS

- Our forecasts assume that there won't be a second wave of COVID-19 infections and accompanying national lockdown. Should this assumption be wrong, growth over the next two years could be materially lower than expected.
- There are also upside risks. Some recent data point to considerable momentum and pent-up demand as countries emerge from lockdown. If this is sustained and is accompanied by significant fiscal stimulus, as seems likely, economic growth could be stronger than expected.

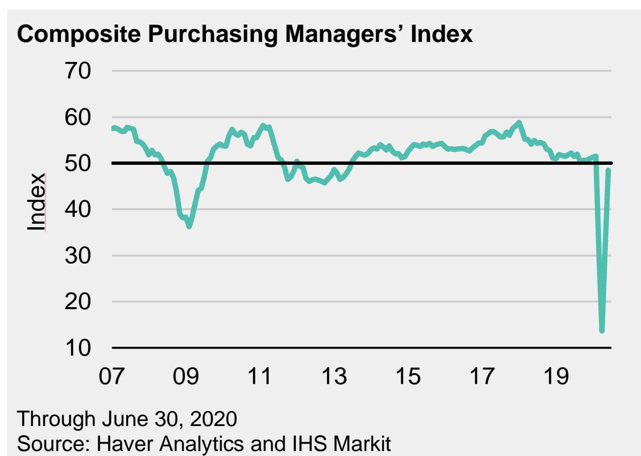
OVERVIEW

Recent data confirm that euro-area activity is picking up as governments begin to relax restrictions on economic and social activity. This is true for traditional indicators, like the composite PMI which rose to 48.5 in June from 31.9 in May, and newer measures like the mobility indices provided by Apple and Google, which have been on an upward trend since April and are now approaching more normal levels of activity.

The speed of the upturn is not, however, uniform. German retail sales rose strongly in May and are now 3.6% higher than they were in February. But this impressive performance was not matched in the other large euro-area countries, with May retail sales still down 14% on February in France, 15% in Italy and 19% in Spain.

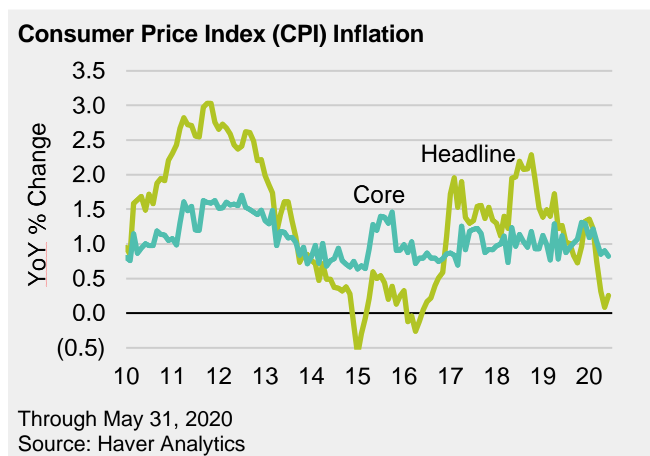
The strength of monthly growth rates may also paint a misleading picture. Confindustria, the Italian employers' federation, reported that a 32% increase in May industrial production was followed by a lackluster 4% gain in June leaving output 22% lower than in February. A sharp rebound in activity is almost inevitable as economies reopen but that momentum will be difficult to sustain and additional policy support is therefore essential.

Composite Purchasing Managers' Index



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

Consumer Price Index (CPI) Inflation



Through May 31, 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	1.1	8.8	2.8	3.0	4.35	4.10	2.30	2.50	7.10	7.10

OUTLOOK

+ China's official real GDP growth rate will likely be about 1.1% in 2020, down from 6.1% in 2019. The main drivers: weakness in capex and the impact from the COVID-19 epidemic. We expect 2021 growth to rebound to about 8.8%.
+ Continued monetary- and fiscal-policy easing should counter downward pressure on the economy, with the focus likely on infrastructure projects and property easing—the 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

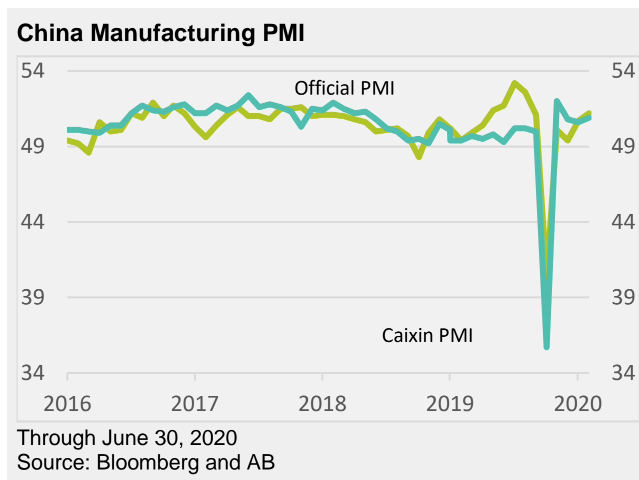
+ Policy easing may be less effective than expected if economic data surprise significantly to the downside. This would put a sustained economic stabilization at risk this year and next.
+ With COVID-19 now a global pandemic, there will be further downward pressure on the Chinese economy from imported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

OVERVIEW

Over the month of June, the market has revised down China's expected 2020 real GDP growth, with the IMF cutting to 1%. The consensus is down to 1.8%, close to our forecast at 1.1%. Where is the drag? Clearly it is from the weak second-quarter GDP, especially during the month of June, mainly driven by persistent high daily increases in COVID-19 globally. China can't fully relax its restrictions without risking a second wave in Beijing and nearby cities, which would hinder economic recovery.

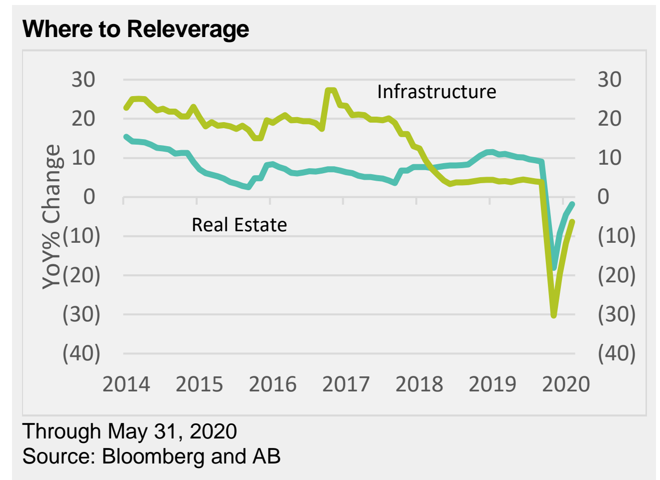
Stimulus expectations for China are high, but over the month of June the delivery of stimulus was not significant. As China was hit first by COVID-19, a faster recovery in the economy makes Chinese policymakers hesitant to launch big stimulus measures including a reserve requirement rate cut in June, preferring to leave all these bullets for the future. In addition, Chinese markets haven't yet been turbulent, which reinforces the case for saving the stimulus bullets. Another risk in our mind is that China's "first in first out" advantage is based on stringent control of imported cases. So far, people with foreign visas are still prohibited from entry into the country, and even Chinese nationals seeking to come back need to apply for re-entry and provide valid reasons. What if the border is reopened? Will imported cases shake the current stabilization in the COVID-19 situation in China? It is uncertain whether COVID-19 may in fact persist as a new normal.

China Manufacturing PMI



Through June 30, 2020
Source: Bloomberg and AB

Where to Releverage



Through May 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	(4.0)	2.5	0.0	0.7	(0.10)	(0.10)	0.00	0.00	105	105

OUTLOOK

- The count of new COVID-19 cases in Japan started to creep higher through late June and into July, but absolute numbers are still low relative to the experience elsewhere.
- In addition to the impact of restrictions and consumer wariness, the collapse in global demand and confidence will also hurt Japanese growth in coming quarters.
- Massive fiscal stimulus will help to support the post-restriction recovery, facilitated by the Bank of Japan.

RISK FACTORS

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

OVERVIEW

First-quarter GDP was negative (–0.9% quarter on quarter), as the impact of COVID-19 on private sector spending started to become apparent. Japan's second-quarter GDP will be sharply negative too—roughly in line with the experience in other developed economies—and would mark three consecutive quarterly GDP declines. The spillover to the labor market has been limited compared with other developed economies.

The nationwide state of emergency was lifted on May 25, restrictions were relaxed, and measures of mobility had shown substantial improvement. To cushion the COVID-19 impact, the government announced another fiscal package in May—a total program size of Y117 trillion or 21% of GDP—on top of a nearly Y100 trillion package revealed in April. Not all of this is effective stimulus—"real water" in Japanese parlance—but the fiscal boost and budget-deficit blowout will nonetheless be substantial. With the BOJ dropping its JGB purchase target in April—allowing "unlimited" bond buying—the extra bond issuance should easily be absorbed. Japan remains at the forefront of fiscal-monetary cooperation: "joined-at-the-hip."

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)	3.1	1.0	1.6	0.25	0.25	0.88	0.88	0.69	0.69
New Zealand	(6.0)	4.5	1.3	1.9	0.25	0.25	0.88	0.88	0.65	0.65

AUSTRALIA/NEW ZEALAND

- Until late June, COVID-19 looked to be well under control in both Australia and New Zealand—indeed, virtually eliminated in the latter. As a result, lockdowns and other restriction were lifted, and activity was recovering smartly.
- But in Australia, the lifting of social distancing restrictions has seen a surge in cases—particularly in the state of Victoria—and a partial lockdown has been reimposed.
- And while substantial stimulus—including a range of support measures such as wage subsidies—had been put in place to cushion the economies through the shutdown, there are question marks over how long these measures will remain in place. Australia's JobKeeper program, for example, was set to expire at the end of September. With lockdowns reimposed, and sectors such as international tourism and education not back to "normal" any time soon, we're watching the risk of a premature unwind of fiscal support measures.
- On the monetary side, however, the measures will remain in place. Both antipodean central banks will continue to anchor yields for an extended period via their quantitative easing / yield-curve control programs.

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	(4.5)	3.3	0.5	2.5	0.25	0.25	0.50	1.00	1.40	1.35

OUTLOOK

+ Canada has made strong progress at containing the COVID-19 virus, but the cost has been a recession, as is the case elsewhere. In times of global distress, Canada often faces a double whammy because of its reliance on external trade and commodity prices. It is good news that the global situation has stabilized, but the level of activity remains low.
+ As expected, the change at the top of the Bank of Canada has not led to any meaningful change in the likely path of policy.

RISK FACTORS

+ If trade policy becomes a hot topic as the US election approaches, Canada may get drawn into a conflict it would rather avoid.

OVERVIEW

Canada's recession has a certain cause—COVID-19—but uncertain depth and duration. Policymakers have responded aggressively and effectively. That paves the way for an economic rebound, though the magnitude of that rebound will depend on factors largely beyond Canada's borders. It is likely that the next couple of months will look pretty good, but after that things get less certain.

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	1.8	0.10	0.10	0.15	0.50	1.20	1.25

OUTLOOK

+ The British government has responded forcefully to support households and firms during the COVID-19 lockdown. But these efforts risk being undermined by a hesitant withdrawal of restrictions and inconsistent communication. Mobility indicators from Apple and Google suggest that activity is picking up much more slowly in the UK than in other large European economies.
+ The deadline for extending the UK's Brexit transition phase has passed. The best-case scenario for the end of the year is now a rudimentary trade deal, providing a zero-tariff regime for goods but with no provision for services and the UK leaving the EU's customs union. However, it's also possible that there won't be an agreement and that the trading relationship between the UK and EU will default to World Trade Organization (WTO) terms at the end of 2020.
+ Either of these two outcomes would be disruptive and would once have been considered hard Brexits. Coupled with a hesitant recovery from lockdown, the UK looks set to underperform in coming quarters despite the promise of additional fiscal stimulus.
+ The Bank of England's decision to lift its asset purchase target by just £100 billion in June was disappointing. This timid increase—and Chief Economist Andy Haldane's decision to vote against the move—was driven primarily by indications that the economy had not been as weak as expected at the time of the May Inflation Report. But the road to recovery is likely to be a long one, and the need to provide room for additional fiscal stimulus points to further increases in the asset-purchase target in coming quarters.

RISK FACTORS

+ The key risk factors likely to affect the economic outlook are how quickly the economy emerges from lockdown and Brexit negotiations. Although the pound has weakened in recent months, the balance of risks is still skewed to the downside.

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	**(2.7)**	**4.9**	**2.0**	**2.5**	**2.00**	**1.77**	**3.74**	**3.89**	**—**	**—**
Hong Kong	(5.5)	4.0	2.8	2.5	1.00	0.90	0.76	0.77	7.78	7.80
India	(4.5)	6.0	3.4	3.9	3.00	2.50	5.80	6.00	77.00	76.00
Indonesia	(1.0)	5.0	3.0	3.2	4.00	3.50	7.80	8.00	15,000	14,500
South Korea	(0.2)	3.0	0.3	1.0	0.50	0.50	1.25	1.25	1,250	1,200
Thailand	(6.5)	3.5	0.2	0.8	0.50	0.50	1.00	1.00	33.00	34.50

OUTLOOK

+ The economic impact of COVID-19—travel restrictions, lockdowns, supply-chain disruption, weaker global demand and impaired confidence—remains the dominant driver.
+ Policymakers have, in general, responded well. The virus remains contained in most countries in the region. And monetary and fiscal support have been delivered.
+ But challenges remain, particularly with the blowback of weaker developed-market demand, the risks around second waves, and question marks around how far “unconventional” policies can be pushed.

RISK FACTORS

+ COVID-19, US-China tensions

OVERVIEW

COVID-19 is the only factor influencing the outlook in Asia ex Japan right now. Responses to the virus itself—including lockdowns, testing and case tracking—have been relatively successful. Taiwan and Korea stand out on this front. But in Thailand, Vietnam and Malaysia the case counts also remain low. The explosion of cases in Singapore—due to clusters in migrant-worker hostels—has been declining since late April. But it remains a reminder that even the best test/track/isolate regimes can have blind spots. Trends in India, Indonesia and to some extent the Philippines remain a concern.

The economic policy response to date has also been positive—with monetary easing and substantial fiscal support being delivered across the board. This should help underpin recovery as restrictions begin to be lifted.

That said, the anticipated headwind of weaker domestic demand from the US and Europe remains, as they endure the worst parts of their economic sudden stop, and attempt to navigate the prospect of a second wave. It’s a reminder that even if COVID-19-related uncertainty begins to clear, the headwinds from other factors—deglobalization and the US-China conflict—will remain stiff.

In addition, there are growing question marks over policy credibility. The Philippines, India and Indonesia, among others, have ventured down the path of unconventional monetary policy, intervening in domestic government bond markets to smooth volatility and to facilitate financing of expanding fiscal deficits (forms of QE, if you like). Indonesia has gone the furthest here—with an explicit “burden-sharing” agreement between the finance ministry and the central bank (BI). Market concerns have been eased by the structure of this agreement, and by the commitment that it is a “one off.” Maybe that will 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)**	**3.5**	**8.0**	**6.7**	**6.44**	**5.78**	**5.82**	**6.45**	**—**	**—**
Argentina	(9.5)	3.5	45.0	35.0	35.00	30.00	—	—	75.00	80.00
Brazil	(7.1)	3.0	3.4	3.6	2.00	2.50	6.80	7.50	5.25	5.00
Chile	(6.5)	5.1	2.9	2.5	0.50	0.75	2.50	3.00	830	850
Colombia	(6.5)	6.0	2.8	3.0	2.25	2.75	5.50	6.00	4,000	4,100
Mexico	(7.5)	2.5	3.0	3.7	4.50	4.50	5.50	6.25	24.00	24.50

OUTLOOK

+ COVID-19 infections continue to grow, especially in Brazil. Strict lockdown measures have begun to be lifted and mobility is increasing, even in areas where the virus continues to spread.
+ Many regional central banks have eased monetary policy considerably since the onset of the coronavirus crisis. Further “residual” rate cuts are expected in Mexico, Brazil and Colombia to provide additional stimulus during the recovery.

RISK FACTORS

+ The speed of the recovery in countries where the virus continues to spread is highly uncertain. Officially, businesses will begin to open, but consumer preferences may not rebound as quickly. Most economies do not have policy space to increase stimulus if the recovery is slower than anticipated.

OVERVIEW

Brazil remains a global hotspot of COVID-19. The virus curve has not yet peaked, but states and cities have begun reopening in order to start the economic recovery. Mobility through the country, which never fully locked down, is starting to increase, although not as quickly as elsewhere in the region. The federal government approved an extension of some of its direct fiscal stimulus measures, including an additional R$100 billion in cash transfers, despite little room to expand the fiscal deficit. May retail sales jumped nearly 14% month over month, with increases in almost every category, implying that consumers may be more active in the economy, but sales are still down versus a year ago. We expect activity to be slower in Brazil than elsewhere in emerging markets despite less intense lockdowns and large stimulus measures because consumer and business confidence remains low and there has been a delay in structural reforms.

In Mexico, the negative shock in activity from the spread of the virus seems to have turned the corner in June. The growth rate in the official number of accumulated COVID-19 cases reached around 2.5% per day in the past couple of weeks, while the official rate of mortality has dropped off its highs but remains at around 12%. However, partial resumption of what the government catalogues as “essential activities” implies we should expect a rebound in activity in coming weeks. In particular, the rebound in activity in the auto sector will improve the performance of the manufacturing sector in June. We expect activity to fare the worst in Mexico given the lack of fiscal stimulus and an already weak trend growth before the shock. The current crisis muted the positive tone from the new USMCA that came into effect on July 1.

We expect the deceleration to be deeper than previously expected in the Andeans, as the virus containment measures have not allowed for a full reopening in activity. The high level of informality and population density has impacted these countries disproportionally despite efforts to contain the spread of the virus and mitigate the impact on economic activity. For 2021, however, we expect steep recoveries as the full effect from expansionary fiscal and monetary policy, along with a gradual normalization in activity, contributes to previously high trend growth.

Debt negotiations continued in Argentina to restructure more than US$60 billion in external debt. We see as a necessary condition for the recovery a successful solution to the debt restructuring in the short term. The government’s constraints on financing have forced it to rely on credit from the central bank, increasing the likelihood of a spike in inflation that could hinder economic stability once activity resumes after the current lockdown period.

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	**(5.6)**	**4.0**	**4.6**	**5.2**	**3.83**	**4.25**	**6.61**	**6.32**	**—**	**—**
Hungary	(7.6)	6.2	2.5	3.3	0.50	0.75	1.40	2.10	370	345
Poland	(6.0)	6.6	2.8	3.1	0.10	0.10	1.20	1.65	4.65	4.45
Russia	(4.9)	2.9	3.4	3.8	4.00	4.00	6.20	5.90	72.50	68.00
South Africa	(8.0)	2.7	3.4	3.9	3.50	4.25	8.90	9.10	17.00	17.80
Turkey	(4.2)	3.9	10.0	11.5	8.00	10.00	13.00	12.00	7.35	7.00

OUTLOOK

+ EEMEA real growth prospects have deteriorated markedly for 2020, because of weaker external demand (a large euro-area recession) and domestic lockdown measures to contain COVID-19. Lower energy prices also weigh on real GDP growth for the region’s oil exporters.
+ Given a challenging growth outlook, most central banks will continue to ease monetary policy and could increasingly consider more unorthodox policy measures, such as bond purchases, to support domestic financial liquidity.

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. Governments’ exit strategies from current lockdown measures and their ability to prevent a second spike in infections will influence the shape of the recovery.

OVERVIEW

Allegations of Russian bounties on US military personnel have brought back into focus the scope of US Congressional approval for further sanctions against Russia. This—despite solid macroeconomic fundamentals—may require a more cautious stance on Russian assets going into the elections. Granted, the likelihood of sanctions being imposed is difficult to pin down but what stands out this time is the nature of the latest allegations. We believe there is a distinct difference between election hacking/interference and alleged killing of US military personnel. Also, there has been growing criticism among Democratic and Republican Senators of how President Trump has handled these allegations. Against the background of the upcoming presidential elections, recent developments seem to bear a greater risk of fostering broader bipartisan support to approve further Congressional sanctions against Russia. There is also a question mark over market sentiment towards Russia if perceived chances of a presidential victory by Joe Biden gained greater traction, as a Biden presidency would likely herald a more hawkish geopolitical stance towards Russia.

South Africa’s special adjustments budget, tabled last month, failed to inspire. While the updated headline fiscal numbers were broadly in line with market expectations, execution risk is high considering the magnitude of planned expenditure cuts. And it is important to bear in mind that this new budget is merely a “bridge” to the October Medium Term Budget Policy Statement (MTBPS). Although a more comprehensive fiscal picture will only be provided in October, local bond issuance has already been increased and uptake has been relatively lackluster. There are some positive developments, including tentative reform at key state-owned companies (Eskom and SAA), the rebuilding of institutional capacity at the South African Revenue Services (SARS) and progress on high-profile corruption cases. But the risk is that the rise in COVID-19 cases could derail plans and political willingness to cut expenditure, which could lead to further adverse fiscal adjustments in the MTBPS.

Frontier Markets

Since Lebanon's hard default on its external debt at the start of March, deep political divisions have prevented meaningful progress on reforms and talks with the IMF and bondholders, likely keeping recovery values for Eurobonds suppressed. To its credit, the government was quick to publish several detailed plans which aimed to address fiscal consolidation, structural reform and the restructuring of sovereign external and domestic debt obligations, as well as liabilities of the central bank and the commercial banking sector. These plans also envisioned much needed USD depositor bail-ins and currency devaluation, prerequisites for IMF support. Yet from the outset the authorities faced significant implementation risks, given a wide rift between the government and the banking sector of how to deal with financial sector and central bank recapitalization.

Amidst political infighting, IMF negotiations appear to have stalled towards the end of the second quarter, while macroeconomic conditions continue to deteriorate and risk jeopardizing the plans already drawn up for restructuring. Disagreement over loss accounting on the central bank's balance sheet, as well as insufficient details on fiscal consolidation, remain significant obstacles for formal IMF assistance. Resignations of Lebanese finance ministry officials and IMF negotiators have also contributed towards delays. The lack of progress with the IMF has also seemingly prevented any meaningful engagement with bondholders and negotiations over the restructuring of Eurobonds. In the meantime, a significant shortage of foreign exchange has led to a collapse in the local currency, invalidating previous macro assumptions and restructuring plans. At this juncture, Lebanon requires political consensus before significant progress can be made on reform, IMF engagement and debt restructuring.

In Ukraine, the resignation of central bank (NBU) governor Smoliy on July 1 owing to mounting political pressures constituted a negative surprise, prompting the finance ministry to cancel its Eurobond deal announced the previous day. Given the importance of NBU independence for international financial institutions (IFIs) such as the IMF, Ukraine risks missing out on US$3.5 billion in IFI financing in the second half of 2020 and compromising its ability to issue a new Eurobond. This would put the overall possible financing shortfall at around US$4.5 billion during the remainder of the year if the NBU governor reappointment is not resolved quickly. Yet we believe that exactly these financing pressures, the lack of alternatives and several potential credible compromise candidates as new NBU governors will incentivize the government and parliament to resolve the issue in a timely fashion. This should also reduce risks of significant IMF review delays and IFI disbursals, as well as allow Ukraine to maintain market access.

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Global	(4.7)	5.0	1.7	2.6	1.51	1.43	1.53	1.81	-	-
Industrial Countries	(6.3)	4.1	0.5	1.8	(0.07)	(0.07)	0.14	0.49	-	-
Emerging Countries	(2.1)	6.4	3.6	3.7	3.97	3.73	3.74	3.88	-	-
EM ex China	(4.7)	4.3	4.3	4.3	3.72	3.48	5.05	5.20	-	-
United States	(4.3)	4.0	0.5	2.5	0.13	0.13	0.50	1.00	-	-
Canada	(4.5)	3.3	0.5	2.5	0.25	0.25	0.50	1.00	1.40	1.35
Europe	(9.7)	4.7	0.6	1.3	(0.37)	(0.36)	(0.35)	(0.09)	1.64	1.66
Euro Area	(10.0)	5.0	0.5	1.2	(0.50)	(0.50)	(0.50)	(0.25)	1.08	1.13
United Kingdom	(10.0)	3.5	0.8	1.8	0.10	0.10	0.15	0.50	1.20	1.25
Sweden	(5.5)	4.5	0.8	1.3	0.00	0.00	(0.15)	0.10	10.5	10.3
Norway	(5.0)	4.5	1.1	1.7	0.25	0.50	0.75	1.00	10.8	10.5
Japan	(4.0)	2.5	0.0	0.7	(0.10)	(0.10)	0.00	0.00	105	105
Australia	(4.4)	3.1	1.0	1.6	0.25	0.25	0.88	0.88	0.69	0.69
New Zealand	(6.0)	4.5	1.3	1.9	0.25	0.25	0.88	0.88	0.65	0.65
China	1.1	8.8	2.8	3.0	4.35	4.10	2.30	2.50	7.10	7.10
Asia ex Japan & China	(2.7)	4.9	2.0	2.5	2.00	1.77	3.74	3.89	-	-
Hong Kong	(5.5)	4.0	2.8	2.5	1.00	0.90	0.76	0.77	7.78	7.80
India	(4.5)	6.0	3.4	3.9	3.00	2.50	5.80	6.00	77.0	76.0
Indonesia	(1.0)	5.0	3.0	3.2	4.00	3.50	7.80	8.00	15,000	14,500
Korea	(0.2)	3.0	0.3	1.0	0.50	0.50	1.25	1.25	1,200	1,200
Thailand	(6.5)	3.5	0.2	0.8	0.50	0.50	1.00	1.00	33.0	34.5
Latin America	(7.6)	3.5	8.0	6.7	6.44	5.78	5.82	6.45	-	-
Argentina	(9.5)	3.5	45.0	35.0	35.00	30.00	0.00	0.00	75.0	80.0
Brazil	(7.1)	3.0	3.4	3.6	2.00	2.50	6.80	7.50	5.25	5.00
Chile	(6.5)	5.1	2.9	2.5	0.50	0.75	2.50	3.00	830	850
Colombia	(6.5)	6.0	2.8	3.0	2.25	2.75	5.50	6.00	4,000	4,100
Mexico	(7.5)	2.5	3.0	3.7	4.50	4.50	5.50	6.25	24.0	24.5
EEMEA	(5.6)	4.0	4.6	5.2	3.83	4.25	6.61	6.32	-	-
Hungary	(7.6)	6.2	2.5	3.3	0.50	0.75	1.40	2.10	370	345
Poland	(6.0)	6.6	2.8	3.1	0.10	0.10	1.20	1.65	4.65	4.45
Russia	(4.9)	2.9	3.4	3.8	4.00	4.00	6.20	5.90	72.5	68.0
South Africa	(8.0)	2.7	3.4	3.9	3.50	4.25	8.90	9.10	17.0	17.8
Turkey	(4.2)	3.9	10.0	11.5	8.00	10.00	13.00	12.00	7.35	7.00

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

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