AllianceBernstein®

GLOBAL ECONOMIC RESEARCH

GLOBAL MACRO OUTLOOK

SEPTEMBER 2020

KEY FORECAST TRENDS

- Our estimates suggest that the global economy contracted by 10% in the first two quarters of 2020, roughly three times as big as during the global financial crisis.
- Not surprisingly, recent data point to a better third quarter: there was always likely to be a mechanical bounce in activity as economies emerged from lockdown. But the road to a full recovery is likely to be long, with output in many countries unlikely to return to pre-crisis levels until well into 2022.
- It's not just about disruption and dislocations caused by COVID-19. Other threats loom, including the US presidential election and a deteriorating global geopolitical environment – particularly relations between China and the West.
- The trick for investors is to balance this challenging fundamental backdrop against the promise of sustained policy stimulus and the likelihood that governments and central banks will respond forcefully to any setbacks.
- A negative view on risk assets requires a combination of economic disappointment and policy error. The latter looks unlikely now that governments have discovered the secrets of joined-at-the-hip monetary/fiscal coordination. With central banks pinning interest rates close to zero, the near-term cost of additional fiscal stimulus is low.
- We continue to think that the euro will strengthen against the dollar. With the US Federal Reserve (Fed) switching to a new, looser policy regime, this is now supported by potential dollar weakness as well as improved euro-area governance.

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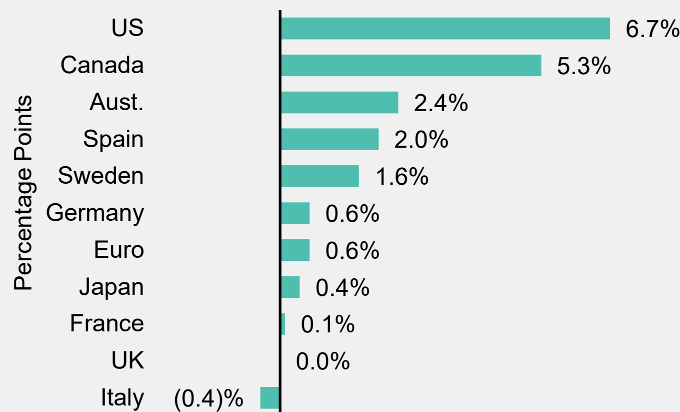
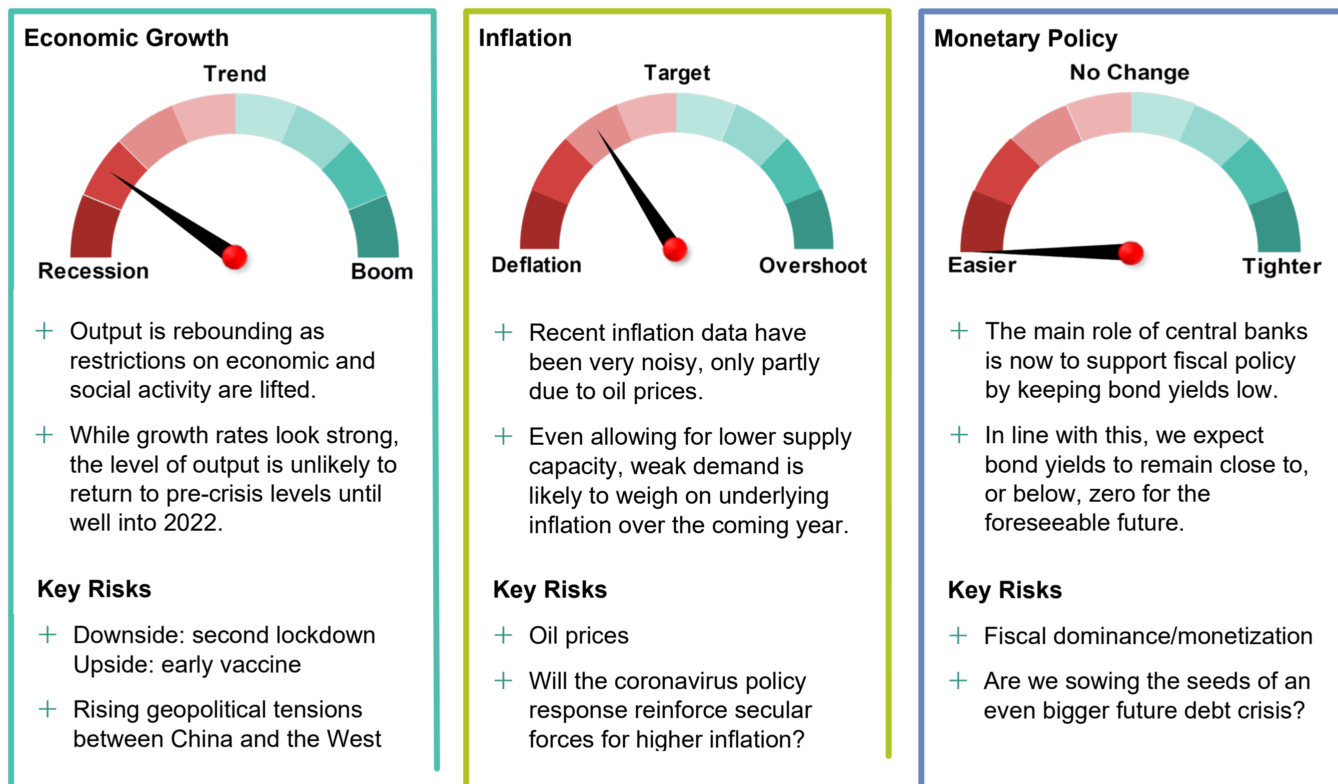
Labor-Market Conundrum



As of August 31, 2020
Source: Haver Analytics

- While the US has dealt with virus-related disruption by providing income support for unemployed workers, most European countries have paid companies to maintain workers on their payrolls. This has resulted in hugely different labor market outcomes.
- Both approaches have merits. In Europe, the impact of COVID-19 has been softened for millions of people, but might this prevent the labor-market from adjusting to the "new normal" and weigh on productivity? The longer this support continues, the greater the risk with this approach.

GLOBAL FORECASTS



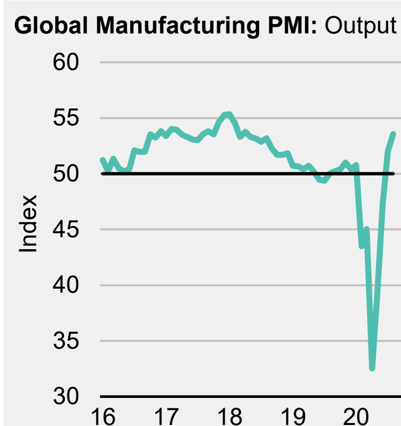
OUTLOOK

- We have made no significant changes to our global forecasts this month. We expect the global economy to contract by 4.8% this year, then grow by a similar amount next year. While this looks "V-shaped", the level of global output at the end of next year is likely to be slightly below its level at the end of 2019 and roughly 6% below a simple extrapolation of the pre-crisis trend. That shouldn't be surprising: a shock like COVID-19 is likely to leave deep scars.

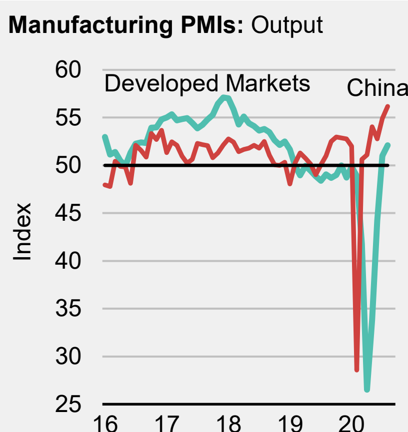
- The near-term outlook for inflation remains uncertain. Beyond the noise caused by disruptions and dislocations related to COVID-19, the cyclical story is likely to be determined by a tug-of-war between weak demand and the economy's impaired supply capacity. While it's difficult to be certain which of these forces will be more powerful, our money is on deficient demand and modest downward pressure on underlying inflation over the forecast horizon.

- The longer-term outlook for inflation is likely to be driven by changes in the monetary regime rather than the balance of power between supply and demand. And the Fed's recent switch towards average inflation targeting marks another step towards a more inflationary regime. We doubt that this move alone will break the back of persistently weak inflation, but the building blocks for higher inflation outcomes are gradually falling into place, including increased fiscal dominance.

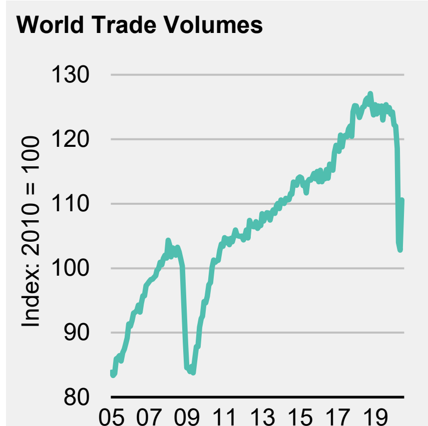
Global Cyclical Outlook: Recovering from a Deep Downturn



Through August 31, 2020
Source: Haver Analytics and IHS Markit



Through August 31, 2020
Source: Haver Analytics and IHS Markit



Through June 30, 2020
Source: Haver Analytics

GLOBAL MARKET OUTLOOK: YIELD CURVES

GLOBAL YIELDS

Global—A key legacy 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 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 that 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 higher to support the economic recovery.

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 the foreseeable future.

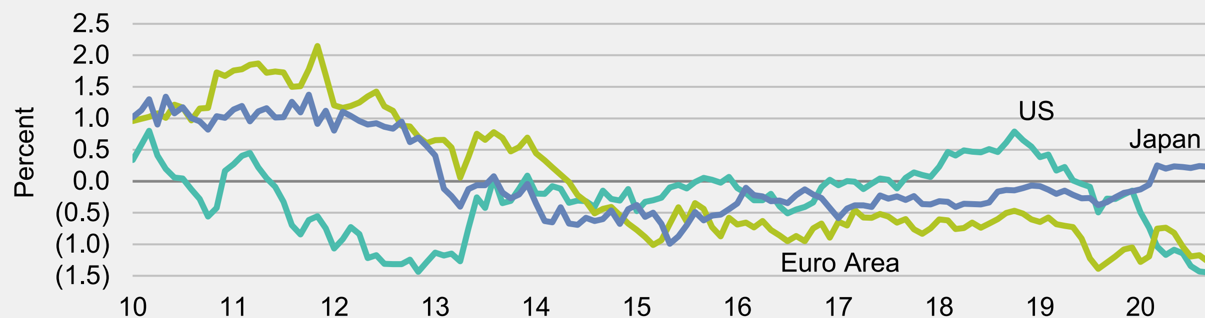
Japan—Tweaks from the Bank of Japan (BOJ)—dropping the Y80 trillion per annum purchase target—largely validate the status quo. Yield-curve control (YCC) should anchor 10-year yields close to zero for the foreseeable future.

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

	AB		Consensus	
	2020	2021	2020	2021
US	0.50	1.00	0.76	1.19
Euro Area	(0.50)	(0.35)	(0.38)	(0.15)
Japan	0.00	0.00	(0.01)	0.04
China	2.30	2.50	2.83	3.03

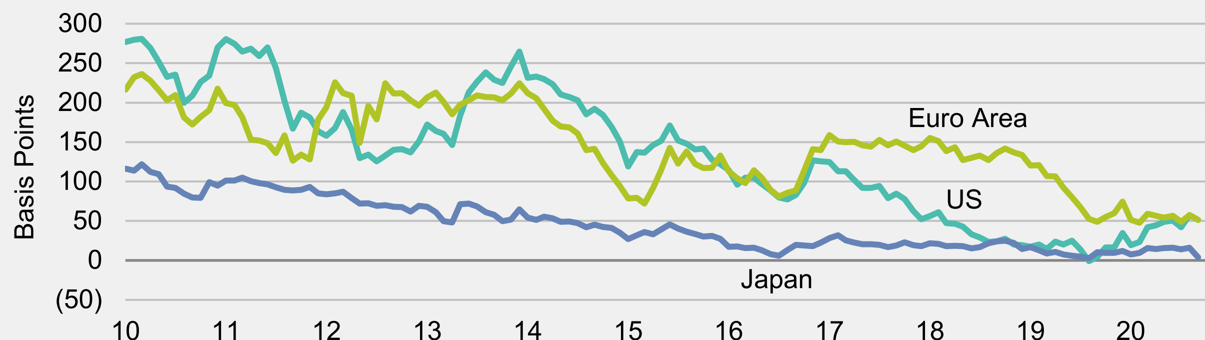
As of September 3, 2020
Source: Bloomberg and AB

Real 10-Year Bond Yields*



*Current 10-year bond yield less five-year/five-year-forward inflation swap
Through September 3, 2020
Source: Bloomberg and AB

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



Through September 3, 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 pick-up in COVID-19 cases, mixed data and ECB commentary have weighed on sentiment. However, we continue to think that a much-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 (%)

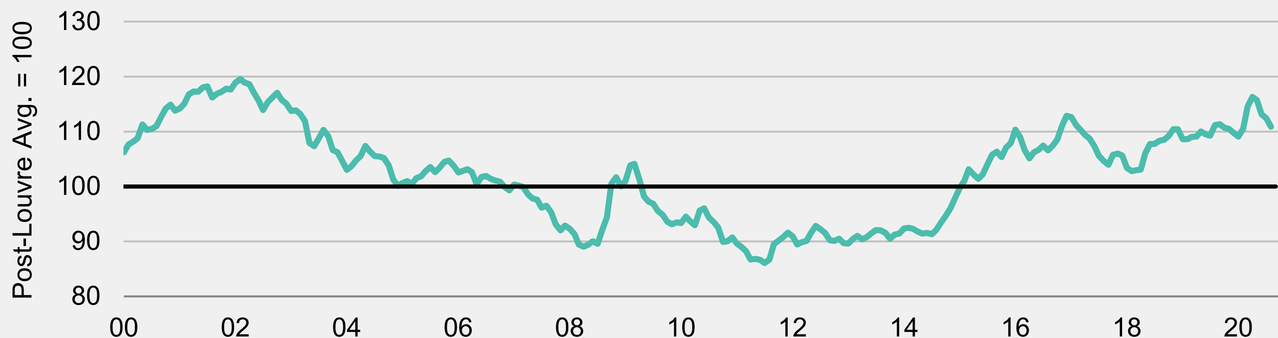
	AB		Consensus	
	2020	2021	2020	2021
EUR/USD	1.30	1.30	1.19	1.23
USD/JPY	102	101	106	105
USD/CNY	6.75	6.70	6.95	6.80
EUR/GBP	0.96	0.96	0.91	0.90

As of September 3, 2020
Source: Bloomberg and AB

Nominal USD Exchange Rate: US Dollar Index

Through September 3, 2020
Source: Bloomberg and AB

Real USD Broad Trade-Weighted Exchange Rate



Through August 31, 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	(5.4)	3.6	0.5	2.5	0.13	0.13	0.50	1.00

OUTLOOK

- The US economy is expanding smartly in the third quarter, driven by consumer spending. Purchases of goods, in particular, have been strong and are now back to pre-crisis levels, though the channel of delivery has changed. Services consumption has been slower to pick up and is likely to remain so.
- The strength of the recovery is down largely to the vigor of policy response, which kept household incomes increasing even in the depths of the crisis. With fiscal stimulus fading, however, the large number of workers currently unemployed are about to take a big hit to their incomes. Absent fiscal stimulus, that is likely to slow the pace of recovery in the fourth quarter and beyond.
- The contours of the upcoming election are gradually coming into focus, and it has the potential to be a volatile and disruptive event both for financial markets and for the real economy.

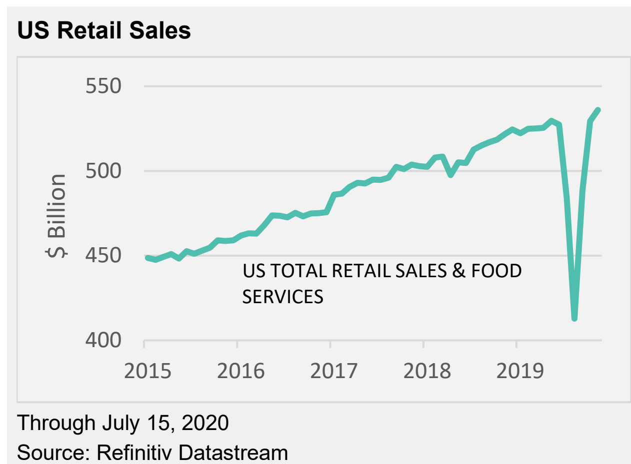
RISK FACTORS

- As the economy reopens, the risk of renewed COVID-19 outbreaks, as occurred over the summer, is going to rise. While a broad national lockdown remains unlikely, state and local responses are going to vary, leading to friction as different parts of the economy operate at different paces in different places.
- The election is likely to cause increased volatility over the next few weeks as negotiations around additional stimulus flounder and financial markets try to predict what the various electoral outcomes will mean in the coming years.

OVERVIEW

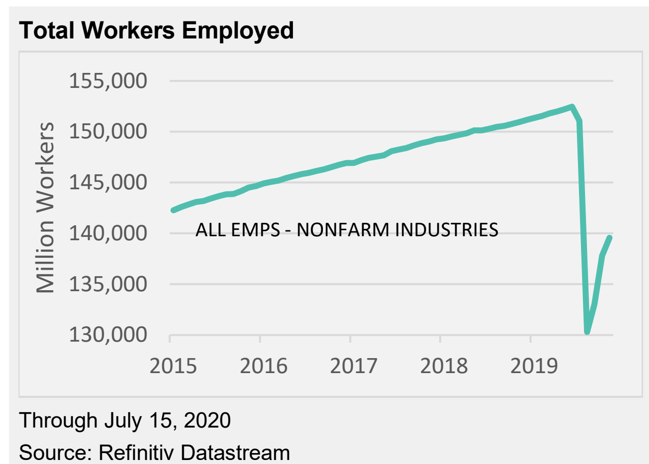
The US economy appears to have regained some vigor, after the renewed circulation of the COVID-19 virus in June and July caused a loss of momentum. With the virus situation again improving, the economy has resumed its expansion and the third quarter looks likely to be robust in terms of GDP growth. We think the road ahead gets harder for two reasons. The first is that the labor market remains weak and households that stayed afloat largely owing to government largesse are about to take a hit to incomes as stimulus programs fade. President Trump's executive orders will ease the near-term impact but are an incomplete and temporary substitute. When incomes slide, we expect consumption to decelerate as well. The second source of concern is that the longer the weakness goes on, the more the economic damage will become permanent rather than temporary. Many workers have and will regain their previous employment, but as time goes on, more and more businesses will not be able to survive, and more and more workers will not have jobs to which to return. Good policy has eased the pain so far, but the electoral cycle is complicating efforts to continue those efforts, and the resulting inaction will increase the extent to which the economic damage becomes permanent.

US Retail Sales



Through July 15, 2020
Source: Refinitiv Datastream

Total Workers Employed



Through July 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)	4.5	0.3	0.8	(0.50)	(0.50)	(0.50)	(0.35)	1.30	1.30

OUTLOOK

+ Second-quarter GDP contracted by 12.1%. This is somewhat smaller than preliminary guidance from national statistical offices, indicating either a smaller hit from COVID-19 lockdowns or a faster pace of recovery in May and June. Although the pace of recovery has slowed in July and August, we continue to expect a strong rebound in third-quarter output.
+ We expect the economy to contract by 7.5% this year before expanding by 4.5% in 2021. While this looks like a "V-shaped" recovery, it would leave the level of output at the end of 2021 roughly 3% below its 2019 year-end level.
+ The spread of COVID-19 has picked up as restrictions on economic and social activity have been relaxed. While this warrants close monitoring, especially in Spain and France, mortality rates remain much lower than earlier in the year and we continue to think that this can be handled by targeted measures rather than new national lockdowns.
+ The European Union's new recovery fund should ensure that all European countries can provide the stimulus needed for their economies to recover from the COVID-19 pandemic. Largely because of the improvement in euro-area governance, we have raised our target range for the euro's exchange rate against the USD to 1.25–1.35.

RISK FACTORS

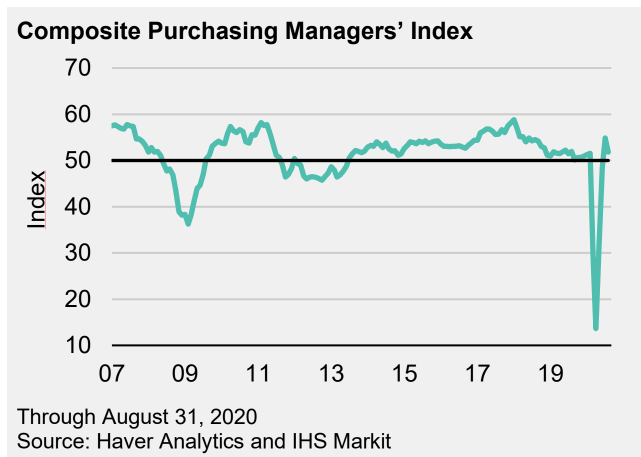
+ Our forecasts assume that there won't be a second wave of COVID-19 infections that overwhelms public health services and forces new national lockdowns. If this proves wrong, growth could be materially lower than expected.
+ Some recent data point to strong momentum and pent-up demand as countries emerge from lockdown. If this is sustained and accompanied by strong fiscal stimulus, growth could return quickly to pre-crisis levels.

OVERVIEW

Although an increase in COVID-19 cases was almost inevitable as Europe's economies emerged from lockdown, the pace of the increase in some countries is worrying. This is particularly true of Spain, where the infection rate has surged above its March peak. The only consolation is that hospitalizations and the mortality rate remain much lower than earlier in the year in all countries. And while this remains the case, governments are likely to respond to rising cases with targeted measures and localized restrictions on economic and social activity rather than new national lockdowns.

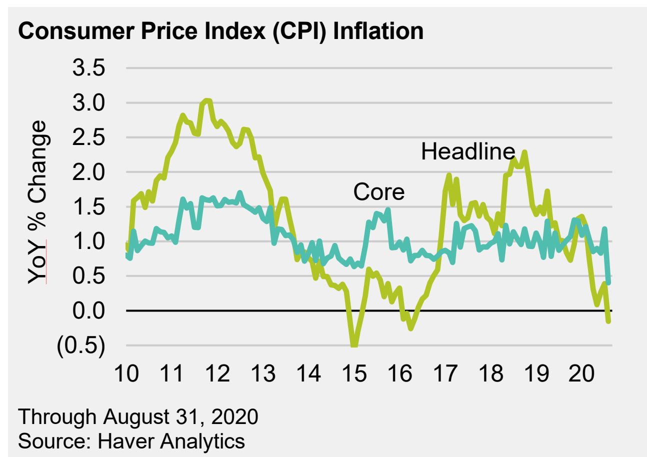
The decline in the composite Purchasing Managers' Index (PMI) from 54.9 in July to 51.9 in August has raised doubts about the strength of the recovery. But we would caution against reading too much into the PMI data in the current environment. The PMI survey asks respondents about the level of certain variables compared with the previous month. As such, the message is that the pace of recovery has slowed rather than gone into reverse. Surveys that focus more on the level of activity, such as the economic sentiment indicator (ESI), continue to improve and paint a picture of an economy that remains on the path to recovery but where the level of output is still well below pre-crisis levels. That seems just about right to us.

Composite Purchasing Managers' Index



Through August 31, 2020
Source: Haver Analytics and IHS Markit

Consumer Price Index (CPI) Inflation



Through August 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	3.00	2.80	6.75	6.70

OUTLOOK

China's official real GDP growth rate will likely be about 1.1% 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 8.8%.

+ 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

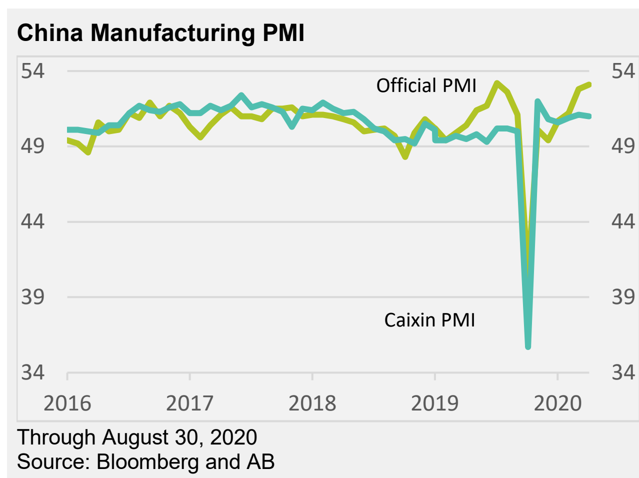
+ Policy easing may be less effective than expected if new economic data offer big surprises to the downside. This would put a sustained economic stabilization at risk for this year and the next.
+ With COVID-19 now a global pandemic, there will be further downward pressure on the Chinese economy from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

OVERVIEW

Throughout August, China's economic recovery remained on track. Highway-traffic flow has reached 1.7 billion person-times, which is 97.4% of the flow for the same period last year. New starts of Shanty town redevelopment construction have accelerated in the summer to complete the full-year target of 56%. Shanty town redevelopment is an important support pillar in stabilizing the Chinese economy, as it underpins demand for steel, cement and construction machinery. Industrial profits have surprised significantly to the upside and extended the stronger growth momentum of recent months (19.6% yoy in July vs. 11.5% in June). China's fall semester school reopening will be on time, given COVID-19 is under control there.

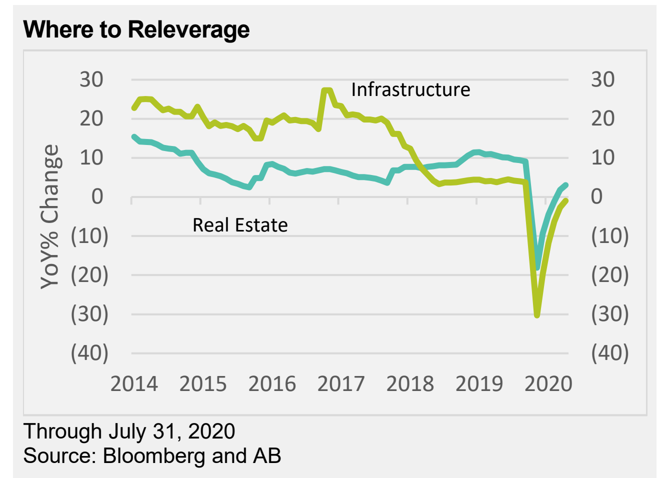
With the economic recovery firmly on track, China appears to be saving some of its policy easing bullets for 2021. China is "first in and first out" for the COVID-19 pandemic, so it doesn't need additional/incremental easing at this stage. Persistent easing is present and ample. Moreover, 2021 marks the start of China's 14th Five-Year Plan. Generally, during the first year of each Five-Year Plan, China kicks off large, strategically important infrastructure projects, which have large funding requirements. Also, 2021 marks the 100th anniversary of the Communist Party, which makes ensuring social, political, and economic stability a more important goal than ever for the government. Will China need aggressive policy easing next year? Probably not. While persistent downward pressure on the economy will require persistent policy easing, a more aggressive approach will only be necessary if risks to economic, political and social stability intensify.

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

- Prime Minister Abe's sudden resignation adds political uncertainty to the mix.
- New COVID-19 cases in Japan remain elevated, albeit below the early-August peaks.
- In addition to the impact of restrictions and consumer wariness, faltering recovery in global demand and confidence will also hurt the country's growth in coming quarters.
- Massive 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

Political change was the dominant news in Japan over the last month, with Prime Minister Abe deciding to resign (after eight years in the top job–Japan's longest serving PM), citing ill health. Given that much of the economic policy agenda has been wrapped up in Abe's name–the "Three Arrows" strategy under the "Abenomics" banner–this naturally raises the question of whether the change in political leadership will necessarily imply a change in economic policy direction. In a nutshell, we think the answer to that question is "no." Aside from the odd wrinkle or two, the broad thrust of policy (under the likely candidates Suga or Aso) is likely to remain unchanged. That is, there is ample fiscal stimulus to support the economy through the COVID-19 crisis and post-pandemic recovery, facilitated by the "unlimited" bond buying by the BOJ. Japan remains at the forefront of fiscal-monetary cooperation– "joined-at-the-hip"–and that's a position that's 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. While substantial stimulus—including a range of support measures like wage subsidies—are intended to cushion the economy through the shutdown, there remain questions over how long these measures will stay in place, and there's substantial "fiscal cliff" risk in the fourth quarter.
- And in NZ, the discovery of a handful of fresh cases prompted a new round of restrictions too (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	(4.5)	3.3	0.5	2.5	0.25	0.25	0.50	1.00	1.30	1.30

OUTLOOK

- The third quarter of 2020 will be strong in terms of GDP growth, though of course it has much to do with the point of comparison: the economic collapse in the second quarter.
- The Bank of Canada (BOC) has begun to muse about following the US Fed's lead and encouraging higher inflation; among major central banks, BOC is one of the most likely candidates to move in that direction.

RISK FACTORS

- Trade policy has not yet become a major variable in the US election, but it could, and Canada could find itself drawn in.

OVERVIEW

As elsewhere, Canada's economy is set to expand rapidly in the third quarter, bouncing back from the lockdown-induced recession earlier in the year. There is plenty of healing to do; the damage was deep, but the early signs are that the recovery is robust. Both fiscal and monetary policy makers are considering measures to extend additional support, and the slope of the near-term trajectory of the economy is likely to depend on the outcome of those discussions, though continued expansion is likely regardless: it is a question of speed rather than direction.

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)	4.0	0.8	1.6	0.10	0.10	0.25	0.40	1.35	1.35

OUTLOOK

- The British economy contracted by a staggering 20.4% in the second quarter, a far bigger decline than in either the US (-9.1%) or the euro area (-12.1%). This is despite the economy being locked down somewhat later than in most of the rest of Europe. As things stand, the UK has the worst economic performance and one of the highest COVID-19 mortality rates in Europe.
- One of the key reasons for this underperformance is the slow pace at which the economy has started to reopen. At first, this was a conscious act of government policy, but it is now primarily a function of mixed messaging and the resultant reluctance of people to return to work. This is despite COVID-19 circulating at a slower pace than in most other European countries, with much of the recent pick up in new cases being explained by increased testing.
- The deadline has passed for extending the UK's Brexit transition phase and negotiations on a new trading relationship with the EU remain deadlocked. The best-case scenario for the end of the year is 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 is equally 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 by year-end.
- Either of these two outcomes would be disruptive—both would once have been considered "hard Brexits." Coupled with a hesitant recovery from lockdown, UK growth looks set to underperform in coming quarters, even with more fiscal stimulus. The case for further monetary policy easing remains compelling, in our view.

RISK FACTORS

- The key risk factors likely to affect the economic outlook are how quickly the economy emerges from lockdown and Brexit negotiations. The UK outlook continues to be 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	**(4.8)**	**5.5**	**2.3**	**2.7**	**1.98**	**1.74**	**3.71**	**3.78**	**—**	**—**
Hong Kong	(5.5)	4.0	2.8	2.5	1.00	0.90	0.76	0.77	7.78	7.80
India	(8.0)	7.5	5.0	4.5	3.00	2.50	6.00	5.90	72.00	70.00
Indonesia	(1.0)	5.0	3.0	3.2	4.00	3.50	7.20	7.60	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 economic impact of COVID-19—travel restrictions, lockdowns, supply chain disruption, weaker global demand and impaired confidence—remains the dominant driver.
+ In general, the virus is contained in most countries in the region. But more flags are being raised around second-wave risks.
+ 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

COVID-19 remains the key factor influencing the outlook in Asia ex Japan. Responses to the virus itself—including lockdowns, testing and case tracking—have been relatively successful. Taiwan and, until recently, Korea (see below) stand out on this front. But in Thailand, Vietnam and Malaysia the case counts also remain low. Trends in India, Indonesia and the Philippines remain concerning.

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 policy response to the surge in new COVID-19 cases in Korea is illustrative here. Social distancing restrictions have been tightened. The government has floated a fourth supplementary budget to help provide support. And the Bank of Korea–with the cash rate at 0.5% close to the effective lower bound–has discussed ramping up Korea Treasury Bond purchases to maintain market stability. A soft form of YCC, if you like.

Korea is following what is becoming a well-worn path. 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. And this month's proposal of a bill which would further undermine Bank Indonesia's independence is a good indicator of the direction of travel.

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	**(7.3)**	**3.5**	**8.2**	**6.5**	**6.39**	**5.76**	**5.82**	**6.45**	**—**	**—**
Argentina	(9.5)	3.5	45.0	35.0	35.00	30.00	—	—	75.00	80.00
Brazil	(5.0)	3.0	3.4	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	830	850
Colombia	(6.5)	6.0	2.5	2.0	1.50	2.50	5.50	6.00	3,800	4,000
Mexico	(9.6)	2.2	3.7	3.3	4.50	4.50	5.50	6.25	23.50	24.00

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.

+ Central banks in Mexico and Colombia are expected to continue easing monetary policy; other countries in the region have reached the end of their cycles and policy rates are expected to remain on hold.

RISK FACTORS

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

OVERVIEW

In Brazil, the significant amount of fiscal and monetary stimulus is having a positive impact on economic activity. Second quarter GDP declined 11.4% year-over-year, avoiding the very deep recession that some had feared. The agricultural sector, which represents roughly 10% of the economy, was up over 1%, and imports have contracted significantly with the decline in aggregate demand. The BRL600 monthly “coronavoucher” transferred to low income families has helped sustain goods consumption, prevented a surge in poverty, and boosted President Bolsonaro’s approval ratings. Although the program has been very successful during the crisis, the planned conclusion at the end of the year is causing tensions between politicians--including Bolsonaro—who want to maintain a high level of social welfare spending, and others, led by finance minister Paolo Guedes, who are concerned about adhering to the fiscal rule that limits public spending. Debates on fiscal policy and reforms are expected to continue over the coming months.

Argentina finalized its external debt restructuring, with holders of more than 93% of the outstanding bonds accepting the government’s offer. The deal reduced debt service payments by US$36 billion and will help the country achieve debt sustainability over the medium term. Now, the focus has shifted to negotiations with the International Monetary Fund (IMF). Argentina had received roughly US$45 billion from the IMF in 2018-19 as part of a stand-by agreement signed by former President Macri. Next year, repayments on the loan start to become due. The government is intending to reschedule payments to a later date in order to create fiscal space and reduce the necessity to rely on monetary financing of the deficit.

In Peru, Congress is discussing reforms to the public and private pension systems which would allow early withdrawals and provide contribution refunds to certain workers. Although intended to provide a boost to incomes during the recession caused by the pandemic, the reforms would cause a significant strain on public finances. The government has drafted a fiscal consolidation plan, but overly optimistic assumptions have created skepticism about whether targets will be achieved. Debt/GDP is expected to rise from 27% in 2019 to over 35% by the end of the year. Second quarter GDP fell 30.2% year-over-year, reflecting the significant impact from the national lockdown. However, leading indicators show the economy began recovering in July.

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**	**4.7**	**5.2**	**3.88**	**4.23**	**6.64**	**6.36**	**—**	**—**
Hungary	(5.7)	5.4	2.7	3.3	0.50	0.75	1.40	2.10	335	330
Poland	(4.5)	5.5	2.8	3.1	0.10	0.10	1.20	1.65	4.32	4.30
Russia	(4.9)	2.9	3.3	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	4.00	9.20	9.50	17.00	17.80
Turkey	(4.2)	3.9	10.5	11.5	8.25	10.00	13.00	12.00	7.35	7.00

OUTLOOK

+ EEMEA real growth prospects have deteriorated markedly for 2020, owing to weaker external demand and domestic lockdown measures to contain COVID-19 spread. Lower energy prices also weigh on real GDP growth for the region's oil exporters.
+ Given a challenging growth outlook, central banks have eased monetary policy and implemented 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. Exchange rate pressures are forcing Turkey to tighten monetary policy.

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 wave of infections will influence the shape of the recovery.

OVERVIEW

Tensions between Russia and the EU and US have been rising meaningfully in the wake of the political turmoil in Belarus and the Novichok attack on Russian opposition leader Alexei Navalny. From a market perspective, the main question is whether the latest developments will increase the risk of renewed sanctions on the Russian sovereign. In the case of Belarus, an overt intervention by Russian security/military personnel would certainly lead to punitive measures as seen in the annexation of Crimea, although at this stage we regard this as a risk scenario rather than the base case.

The attack on Alexei Navalny will trigger a reaction from both the EU and the US. At the time of this writing, pressure has been rising on German Chancellor Angela Merkel to suspend the Nord Stream II pipeline as a form of retaliation. While certainly negative for Russia's geo-energy policy, the near-term economic impact is likely to be limited. From the US side, in the first instance it seems that targeted financial sanctions are possible under the Global Magnitsky Human Rights Accountability Act. The latter will however depend on Russian cooperation to identify individuals to be sanctioned. Failure to do so could increase pressure to pursue other sanctions avenues such as chemical weapons legislation or provide new impetus for US Congressional sanctions bills such as DETER or DASKAA.

In Turkey, the central bank (CBRT) started to tighten lira liquidity in response to increasing exchange rate pressures at the start of August. Instead of implementing an outright interest rate hike, the CBRT opted to move lira funding to different parts of its interest corridor, increasing the weighted average cost of funding (WACF) by about 240 basis points to 10.15% over the course of August. While a step in the right direction, it remains uncertain whether these tightening measures will be sufficient to stabilize the currency and bring about an adjustment in the current account balance. That's mainly because recent FX weakness and associated passthrough pressures on headline inflation will likely leave real interest rates in negative territory, even if the WACF was raised further to the upper end of the interest corridor at 11.25%. We believe that Turkey would have to target positive real interest rates of 2% - 3% to bring about a sustainable positive change in the balance of payments, reserves levels and thus the currency.

Frontier Markets

The IMF approved Gabon's second request for rapid financing at the end of July (the first request was approved in April). The first disbursement under the IMF's Rapid Financing Instrument (RFI) was equivalent to 50% of quota and had been approved before disbursements to the tune of 100% of quota became the norm. The financing top-up that Gabon received was thus to some extent 'procedural', but the balance of payments needs also increased to the extent that additional financial support was urgently required. There was perhaps an assumption at the start of the COVID-19 pandemic that a new Extended Funding Facility (EFF) could be agreed by June—which marked the expiration of the three-year EFF program that started in 2017—and that funding needs will be met in that way. In the event, the sixth and final review under the EFF program was not completed, and expired in June without a follow-up. But the IMF recently indicated that new negotiations have started, and we think the RFI top-up will sufficiently bridge Gabon's funding needs until the likely agreement of a new program before year-end.

The devastating social and economic ramifications of the Beirut port explosion on August 4 may offer a catalyst for political and economic change in Lebanon. The challenges are, however, likely to remain significant for navigating the current economic crisis, successfully engaging with the IMF and completing the sovereign debt restructuring over the coming 12 to 18 months. The Lebanese parliament relatively swiftly appointed new prime minister Mustafa Adib following the government's resignation. The focus will now shift to Adib's ability to swiftly form a cabinet that has the technical capability and–perhaps more importantly–the political room for maneuver to implement necessary reforms, something that the previous government was clearly missing. Fiscal consolidation, loss accounting of the Banque du Liban and the broader restructuring of the banking sector (including deposit haircuts) will be at the top of the agenda in upcoming IMF negotiations.

Following last month's sovereign debt restructuring in Ecuador, the IMF has come to a staff-level agreement for a new US$6.5 billion Extended Funding Facility (EFF). This program, which replaces the EFF that was canceled in April because its conditionality proved too burdensome during the COVID-19 crisis, will provide necessary financing to repay arrears and avoid further fiscal austerity. The country expects to receive US$4 billion in distributions before the end of the year from the IMF and US$2.4 billion from China, which will put the country in a strong financing position going into 2021. The conditionality of the IMF program hasn't been announced yet, but we expect further fiscal consolidation after the presidential election early next year.

AB Global Economic Forecast

September-20

	Real Growth (%)		Inflation (%)		Official Rates (%)		Long Rates (%)		FX Rates vs USD	
	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F	2020F	2021F
Global	(4.8)	4.8	1.7	2.5	1.51	1.43	1.66	1.84	-	-
Industrial Countries	(6.2)	3.7	0.4	1.7	(0.07)	(0.07)	0.15	0.45	-	-
Emerging Countries	(2.6)	6.5	3.7	3.7	3.96	3.72	4.05	3.99	-	-
EM ex China	(5.6)	4.6	4.6	4.3	3.70	3.45	5.04	5.15	-	-
United States	(5.4)	3.6	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	1.30	1.30
Europe	(7.8)	4.4	0.4	1.0	(0.37)	(0.37)	(0.34)	(0.19)	1.83	1.81
Euro Area	(7.5)	4.5	0.3	0.8	(0.50)	(0.50)	(0.50)	(0.35)	1.30	1.30
United Kingdom	(10.0)	4.0	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	1.1	8.8	2.8	3.0	4.35	4.10	3.00	2.80	6.75	6.70
Asia ex Japan & China	(4.8)	5.5	2.3	2.7	1.98	1.74	3.71	3.78	-	-
Hong Kong	(5.5)	4.0	2.8	2.5	1.00	0.90	0.76	0.77	7.78	7.80
India	(8.0)	7.5	5.0	4.5	3.00	2.50	6.00	5.90	72.0	70.0
Indonesia	(1.0)	5.0	3.0	3.2	4.00	3.50	7.20	7.60	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	(7.3)	3.5	8.2	6.5	6.39	5.76	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	(5.0)	3.0	3.4	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	830	850
Colombia	(6.5)	6.0	2.5	2.0	1.50	2.50	5.50	6.00	3,800	4,000
Mexico	(9.6)	2.2	3.7	3.3	4.50	4.50	5.50	6.25	23.5	24.0
EEMEA	(5.1)	3.8	4.7	5.2	3.88	4.23	6.64	6.36	-	-
Hungary	(5.7)	5.4	2.7	3.3	0.50	0.75	1.40	2.10	335	330
Poland	(4.5)	5.5	2.8	3.1	0.10	0.10	1.20	1.65	4.32	4.30
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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	10.5	11.5	8.25	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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