CIBC Asset Management

PERSPECTIVES

For the 12-month period beginning October 1, 2020

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Recovery in the works

Lower interest rates and the prospect of an ongoing economic recovery are supporting higher equity markets. Some market sectors moved too far, too fast earlier in the year, but we see the September pullback as a consolidation after a sharp rally rather than the beginning of a market downturn.

Asset class highlights

Equity: Driven by strong performance in Asia, emerging equities have been the best performing global region, outperforming even the S&P 500.

Fixed Income: Developed market bonds offer little value, while emerging market bonds present better opportunities. We're focusing on select Asian bond markets and lower volatility markets like Chile and Poland.

Currencies: With the Fed policy rate near zero, a global economic recovery underway and the adoption of the new Average Inflation Targeting (AIT) framework, the U.S. dollar will likely come under increasing downside pressure.

China: Large infrastructure and monetary stimulus is boosting China's post-lockdown recovery—which should now be labelled an economic expansion. The Chinese economy is expected to grow at an above-consensus average pace of 10% over the next four quarters.

Multi-asset outlook

Asset class	Current September 30, 2020	Most likely minimum of range for next 12 months	Most likely maximum of range for next 12 months
Canada 3-month T-Bills rate	0.25%	0.25%	0.25%
Canada 2-year government bond yield	0.25%	0.20%	0.60%
Canada 10-year government bond yield	0.56%	0.40%	1.15%
U.S. 10-year government bond yield	0.68%	0.50%	1.25%
Germany 10-year government bond yield	-0.52%	-0.55%	0.30%
Japan 10-year government bond yield	0.01%	-0.25%	0.25%
Canada 10-year real-return government bond yield	-0.20%	-0.10%	0.15%
Canada investment grade corporate spreads	1.38%	1.05%	1.90%
U.S. high yield corporate spreads	5.58%	4.15%	7.25%
Emerging market sovereign (USD denominated) bond spreads	398	250	600
S&P/TSX price index	16,121	15,500	18,400
S&P 500 price index	3,363	3,150	3,750
Euro Stoxx 50 price index	3,194	3,000	3,650
Japan Topix price index	1,625	1,525	1,850
MSCI Emerging Markets	61,978	59,000	71,000
U.S. Dollar/Canadian Dollar	1.3319	1.2800	1.3900
Euro/U.S. Dollar	1.1721	1.1000	1.2000
U.S. Dollar/Japanese Yen	105.48	102.00	111.00
U.S. Dollar/Offshore Chinese Yuan	6.78	6.30	6.90
Gold	1,886	1,700	2,000
Oil price, WTI (West Texas Intermediate)	40.22	40.00	55.00

Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

Asset class outlook

Global overview

Global recovery still on track
In our last quarterly forecast, we concluded that a faster-than-generally-expected global economic recovery was in the making owing to the colossal efforts deployed by fiscal and monetary authorities. Our views haven't changed. Of course, this bullish forecast was and remains conditional on one thing—that the global pandemic doesn't take a turn for the worse. Until recently, the numbers were very encouraging, with pandemic curves flattening in most parts of the world. Lately, however, the number of COVID-19 active cases has been creeping higher in many places. Is this enough to jeopardize the unfolding global economic recovery? We have a few good reasons to doubt that.

With regard to the spread of the COVID-19 virus, it's important to account for the fact that testing capacities have increased considerably since the first outbreak in early 2020. Pretty much everywhere in the developed world, the number of daily COVID-19 tests administered is now five to six times higher than it was last spring. The increase in the number of daily tests is just as impressive for many emerging countries. During the first wave, little testing was done and, as a result, many infections were missed. Now, a lot of testing is occurring and vastly more infections are being detected. When the number of active cases is corrected for this distortion, we realize that the first wave was far larger than what is being seen today. In our baseline projection, we are working with two assumptions. First, that a vaccine will come into play somewhere between the fourth quarter of 2020 and the first quarter of 2021. Secondly, that the second wave will be controlled, so no economic lockdowns like the spring of 2020 will be necessary.

Our optimism about global growth prospects also stems from the policy actions taken by governments and central banks around the world. With policy rates near zero and skyrocketing fiscal deficits, central banks in the developed world had no other option but to radically change their monetary policy operating framework in numerous ways. First, to significantly reduce the risk of a fiscal crisis, central banks have come to the rescue of governments by monetizing a very large chunk of their fast-increasing borrowing needs. In effect, central banks are now buying most of the new bonds issued by governments. In this way, fiscal deficits can grow much larger without raising concerns about explosive debt accumulation because government borrowing costs are kept ultra low.

Central banks are not just expanding their balance sheets to the benefit of governments. They are also doing it to support the private sector. This is done via two channels. First, central banks have been supporting the banking sector by implementing bigger bank lending schemes with much better funding conditions. Second, key support has also been provided to non-financial corporations by broadening asset purchasing programs to include private sector debt.

Taken as a whole, these policy changes have been playing, and will continue to play, a critical role. This is the main reason why the global economy embarked on a road to recovery a lot faster than generally expected. With all the efforts deployed to jumpstart the global economy, a faster-than-generally-expected global economic recovery is likely in the making, with global growth accelerating to +5.2%. This assumes that the global pandemic doesn't take a turn for the worse.

Fed policy: Lessons from the 1940s

The Fed has had a long-standing inflation target of 2%, which has been difficult to achieve in recent years. In August, the Fed adopted an Average Inflation Targeting (AIT) policy framework. Under the new AIT approach, the Fed will try to make up for past deviations from its 2% inflation target. To illustrate, PCE[1] inflation has averaged 1.46% since 2012, -0.54% below target. This implies that the Fed may target 2.54% inflation over the next eight years to get inflation to average 2% over the long run. To do this, it will anchor its policy rate near zero for many years to come.

The parallels between the early 1940s and today's situation are striking. During WWII, the Fed directed its entire open market operations to assist in funding war expenditures. The Federal government's deficit reached record proportions (-25% of GDP) and debt exploded, peaking at 120% of GDP. The Fed's cooperation with the Treasury strengthened after Pearl Harbor, with the Fed's pledge to peg the 3-month T-Bill rate at 0.4% and enforcing a ceiling of +2.5% on longer-term bond yields. Their objectives were clear: (1) lower government debt financing costs and (2) get more inflation in the system to boost nominal growth. This era saw a fast expansion of the Fed's balance sheet (i.e. the Fed purchased government bonds) and deeply negative real rates.

The situation today is very similar. U.S. government debt is on an explosive accumulation path (140% of GDP). The only way to avoid a fiscal crisis is to significantly lower the government's borrowing costs and get more inflation into the system as quickly as possible. From that standpoint, it's the same story as the 1940s. However, there are important differences between the Fed's approach in 2020 versus 1940.

The Fed is currently aiming for the "overall" borrowing cost on new government debt to be significantly lower than the effective borrowing cost on existing government debt. The Fed is targeting the whole government funding structure rather than a certain segment of the yield curve.

The other key nuance is that this time around the Fed is implicitly targeting easy financial conditions. It's not just about keeping funding conditions easy for U.S. nonfinancial corporations with low interest rates. It's also about weakening the U.S. dollar, thereby making U.S. exports more attractive and encouraging U.S. consumers to buy domestic. In our opinion, this significantly increases the Fed's chances of increasing inflation and hitting its new inflation target.

This wasn't the case in the 1940s. Keep in mind that in July 1944, a new international monetary system was forged in Bretton Woods—this replaced the gold standard with the U.S. dollar as the global currency. The U.S. dollar strengthened as a result, with a deflationary impact for the U.S.

Global strategy

A pause on the road to recovery

After a sharp, synchronized rebound in markets during the second quarter, market performance was uneven in the third quarter. As the months passed, the performance changed into a more synchronized correction, with a heightened level of risk aversion reflected in indicators like the VIX. The S&P 500 fell almost 10% from its peak, while oil, industrial metals, high-yield corporate bonds and emerging market sovereign bonds all corrected. The USD, a typical safe haven, rallied, but other safe havens, like G10 government bonds, failed to move and gold actually corrected significantly.

This unusual market dynamic points to a move that was partly driven by market sentiment (i.e. markets had moved too far, too fast, with a lot of speculative froth) and partly by fundamentals. A second outbreak of COVID cases led to uncertainty about the future path of the recovery. Also, after announcing a new Average Inflation Targeting (AIT) policy framework, the U.S. Federal Reserve (Fed) disappointed investors by not increasing asset purchases. They instead highlighted the need for fiscal policy to play a greater role in supporting the economy. With gridlock in Washington, the problem is that a new fiscal package is still being debated in the context of strategic political calculations just ahead of the next presidential election.

Another question that has attracted attention is whether equities have become disconnected from the underlying economic reality. After all, the S&P 500 handsomely surpassed its pre-COVID level only a few months after the worst post-war recession. The economic recovery is expected to continue to surprise the consensus—it will likely be complete by the middle of next year. Equities are a play on the economy and forward-looking, and there are reasons to be optimistic. Furthermore, part of the rise of the equity market can be attributed to lower interest rates, which boost the fair value of P/E ratios.

The bottom line is although there has been some speculative excess (most notably in U.S. large-cap technology shares), the rise of the market seems to be supported by the prospects of a continued economic recovery and lower interest rates. The September correction should be seen as a consolidation of the trend after a sharp rally. Central bank policy will remain highly accommodative for the next few years. Although the outlook for fiscal policy is less clear, the balance of risks should reflect that governments won't want to jeopardize the recovery by pulling out of fiscal stimulus too early. The second wave of COVID-19 bears important differences to the first wave. We can't directly compare the number of new cases because many more tests are being performed. Despite the rising number of new cases, the number of deaths remains relatively stable. Importantly, lockdown measures are more targeted and localized, leading to a more benign economic impact. A vaccine should be available by early 2021 and its distribution will begin soon after. This will be an important milestone on the road to recovery.

The medium-term outlook for the equity market and other cyclical assets is moderately attractive. However, the uncertainties related to the virus and U.S. elections are unlikely to be resolved in the near term. We could remain in an environment where there are few catalysts to push the market higher. With yields near 0% for major government bond markets, the conditions required to generate positive returns in bonds are very narrow. In addition, their ability to offer protection to a balanced portfolio is limited. Overall, our asset allocation strategy remains cautious.

Global equity markets

Sectoral shifts

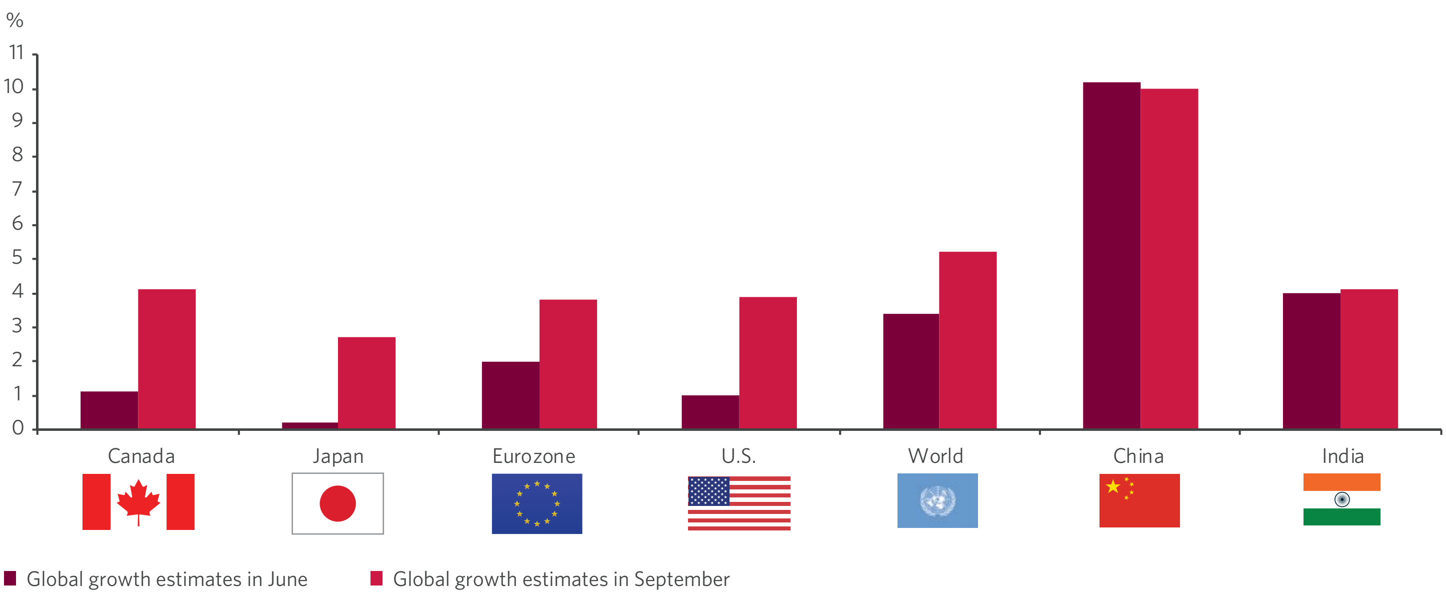
While the overall U.S. equity market made its way back to pre-COVID levels, there were some significant divergences across sectors and countries. The U.S. has generated the most headlines because of the incredible rally in a few technology companies. The NYSE FANG+[2], an index of 10 large-cap U.S. technology companies, not only quickly recovered but increased 38% from its pre-COVID peak and is up 74% year-to-date[3]. These companies were clearly outliers and a close analysis indicates they were subject to irrational speculation. Meanwhile, without attracting as much attention, other sectors like materials and healthcare have also done well (although not nearly as well). Emerging markets has been the strongest region, even outperforming the S&P 500, driven by strong performance in Asia. Energy producers, banks and, on a regional basis, Europe and Latin America, have lagged.

Some industries will continue to face severe headwinds and will likely need many years to recover. For the most part, however, economic activity will not be lost but redistributed, and there will be winners and losers. The strong performance of technology companies reflects this, as they are widely seen as the key beneficiaries of the trend to work-from-home. As a result of reduced demand for transportation, the energy sector has been hit by lower oil prices. Banks are facing a difficult environment of low interest rates and flat yield curves, which dampens their net interest margins. These sectoral divergences can also, with some limits, explain the performance differences on a regional basis. Asia has been strong due to Taiwanese and Korean technology companies, but Europe's banking sector is struggling. Energy-related countries like Brazil and Mexico have underperformed.

Looking at valuation, the regional differences that existed before the pandemic still exist. Those differences were actually amplified following the sharp market moves during the pandemic. The market outlook depends on valuation, how each country copes with the pandemic, and on the policy stimulus delivered to support the economy. The U.S. equity market was the most expensive before the pandemic—it still is and has become even more expensive relative to other regions. The U.S. Congress will most likely come up with a new fiscal package, but when and how it takes shape will be the result of tradeoffs and compromises.

Emerging markets, despite their strong rebound, are still the most attractive. Asia has generally been more succesful at controling COVID-19 (with the notable exception of India). China enjoys political liberties not present elsewhere, and will be able to provide significant fiscal stimulus. A continued economic recovery should lead to stronger commodity prices. This will help commodity-producing countries and emerging markets are likely in a good position to continue to outperform.

Global growth projections: CAM forecast September 2020 vs. June 2020



Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

Global bond strategies

At this point, developed market (DM) bonds offer little value. For most DM bond markets, rate cuts by DM central banks have pushed real yields into deep negative territory. As a result, DM bond investors are not being well rewarded for taking interest rate risks. In addition, central bank asset purchasing programs have moved DM bond yields away from fair value (as calculated using fundamentals), leaving very little risk premium for investors.

Emerging market (EM) bonds represent better opportunities. Several factors should allow EM bonds (in their local currency) to outperform their DM peers. EM valuation has become compelling[4], as most EM yield curves have steepened markedly in the last six months due to significant monetary policy easing across EM central banks. EM bonds also tend to outperform when global leading indicators are improving and when the USD is weakening—we're currently forecasting both in our base case scenario. For EM bonds denominated in USD, their outperformance since April should continue—most EM countries have been able to manage their fiscal challenges relatively well despite the COVID-related shock.

In addition, the recent relative stability of EM local currency versus the U.S. dollar bodes well for EM USD borrowers.

In terms of country allocation, our upbeat view on China's outlook supports an overweight exposure to Asian bond markets like Malaysia, South Korea and Indonesia. These economies should benefit from positive economic spillover from China, leading to sustained foreign inflows into the region and its capital markets. To account for numerous lingering macroeconomic risks, we are focusing on less volatile (lower beta) bond markets for now, like Chile and Poland, which exhibit a decent structural backdrop. We also remain nimble with higher yielding bonds from regions such as South Africa and Brazil, where growth prospects have deteriorated significantly and where their recovery lags other emerging markets.

U.S and Canadian 10-year bond yields should remain fairly stable in the next twelve months, hovering inside a 0.50% to 1.25% range in the U.S. and between 0.40% and 1.15% in Canada.

Top global bond strategies

Reflecting our base case scenario, we recommend a pro-cyclical stance in global bond portfolios. This translates to an **underweight position in developed market** (DM) bonds and **overweight exposure to emerging market** (EM) bonds.

We recommend a **neutral stance on duration** for developed market bonds, as most DM yield curves have become very flat over the last year, leading to unappealing yield roll down opportunities.

In terms of EM country allocation, our upbeat view on China's outlook supports an **overweight exposure to select Asian bond markets**. To account for macro risks, we are also focusing on **lower beta markets such as Chile and Poland.**

Currencies

U.S. Dollar

The U.S. dollar bull market is finally being seriously challenged after being in place since 2011. Is a trend reversal in the making? We believe the odds have significantly increased for several reasons. First, with the Fed cutting its policy rate near zero, the U.S. dollar no longer has an interest rate advantage—this qualifies as a game changer. In addition, the greenback typically underperforms in global economic recovery phases like the one now taking place. Last but not least, with the adoption of its new Average Inflation Targeting (AIT) policy framework, we think the Federal Reserve will implicitly target a weaker U.S. dollar. The strength of the U.S. dollar and its negative impact on America's competitiveness has become an important source of concern for U.S. monetary authorities. This partly explains why the Fed has been flooding the world with U.S. dollar liquidity since March. To be clear, there is a long way to go to restore balance. Over the last decade, the greenback has appreciated by more than 50% on a trade-weighted basis, now qualifying as deeply overvalued. Looking forward, it looks more and more like the greenback will be under intensifying pressure.

Canadian Dollar

With oil prices in a trading range and a supportive risk environment, the Canadian dollar continued its ascent against the U.S. dollar over the third quarter. By early September, bullish investors had enough conviction to try pushing the Canadian dollar higher to break the long-term downtrend in place since 2012 (against the greenback). Unfortunately, the breakout attempt failed, with CADUSD pulling back down to 0.75.

Looking forward, the Canadian dollar is expected to stay well-supported, trading between 0.72 and 0.78 US cents (or 1.28 to 1.39 USDCAD) over the forecast horizon. Any additional upside will be determined by what happens to the U.S. dollar on a widespread basis. To a large extent, this will depend on what happens to the "anti-dollar", the euro. While the Canadian dollar is obviously not a euro-block currency, it typically moves in sympathy in periods of strong euro appreciation against the USD, as do many other currencies. From this angle, a breakout of the EURUSD bilateral exchange rate from its multi-year downtrend would translate to a broad-based depreciation of the U.S. dollar from which the Canadian dollar would likely benefit.

Euro

Over the third quarter, the euro gained a lot of ground on a trade-weighted basis—enough to get the European Central Bank's (ECB) attention. In fact, the eurozone's common currency is now overvalued by more than 5%. In 2011 and 2014, the ECB didn't hesitate and eased its monetary policy stance to stop the euro's ascent. Will this time be any different? At the current juncture, the ECB's big concern relates to developments on the inflation front. CPI inflation has already turned into mild deflation and the strength of the euro on an import-weighted basis is exerting downward pressure on import price inflation. The real question, however, is whether the ECB can actually do something to stop the euro's appreciation. We don't think it can. Between 2015 and 2018, the ECB was buying a lot of government bonds to keep government borrowing costs low. The ECB'S QE essentially involved buying government bonds from the rest of the world, with net bond outflows exerting downward pressure on the euro. Today, the ECB is buying government debt securities to cover a good chunk of the government's new and very large borrowing requirements (i.e. debt monetization). This eliminates the downward pressure on the euro. As a result, fluctuations in the EURUSD bilateral exchange will likely be increasingly dictated by supportive fundamental determinants. The EURUSD exchange rate is projected to trade between 1.10 and 1.20.

Japanese Yen

In the third quarter, the Japanese yen has been extremely well-behaved, trading in a very tight trading range. The Bank of Japan's policy regime is no stranger to this as it involves: (1) debt monetization, implying that the central bank's government bonds purchases are, to a large extent, meeting the government's new borrowing requirements (2) a yield curve control (YCC) policy to keep debt-servicing costs and overall debt under control (3) heavy purchases of private sector debt by the central bank (i.e. commercial paper, corporate bonds, ETFs and REITs) and (4) unlimited support to the banking system via bank lending schemes with ultra-easy lending conditions. The end result: lower-than-usual volatility in Japanese financial markets. In this environment, the USDJPY bilateral exchange rate should also remain well-behaved, fluctuating between 102 and 111.

Commodities

Oil

Following the wild ride earlier in the year, when oil prices went briefly negative in April, we've actually seen some stability in the price since finding a balance at about $40/barrel. Prices have ranged from $36 to $43 from June to October. Of note, September marked the first month in 2020 where global oil demand exceeded supply, signalling a continued shift to reopening of the global economy and an ongoing rationalization of supply.

Looking ahead, all eyes are on the U.S. election and the implications for stimulus and policy changes that could impact energy supply and demand as we move into 4Q2020, 2021 and beyond. The narrative is changing by the day, with hopes of a large U.S. stimulus package seemingly on the table, then off the table, as politicians position themselves ahead of the election. Politics aside, reopening (or not) of the global economy will likely drive the supply/demand balance, and therefore prices, in the oil market in the coming quarters. We'll be watching inventory levels in the months ahead to see if drawdowns gather pace. In particular, we'll be watching for drawdowns of refined products. Demand for this segment will be required for refinery margins to improve and for a sustainable rally in oil prices.

Looking at the supply side, signals on what OPEC plans ahead of its next meeting in November/December will be closely watched. Gradual output growth following the large cuts earlier in the year could be delayed to help balance the market. Given the softness in the global economy, investors are hopeful that output restrictions remain at current levels.

Risks to oil prices include:

- A second wave of virus infections globally that slow a restart of the global economy
- OPEC+ compliance or non-compliance with output restrictions
- Curbing of previous OPEC production cuts
- Libya oil returning to the market
- General risks around the U.S. election and the implications for longer-term energy policy in the country

Gold

The gold price has continued to strengthen through 2020 as global macro risks remain high, and fiscal and monetary policies are increasingly accommodative to provide economic support during the pandemic. Year-to-date, the gold price has appreciated by 25%, to trade around $1,900/oz in October, although the price is down from a peak in August of $2,063/oz, an all-time high in real terms.

The move lower in the gold price from all-time highs over the summer has been orderly, driven by modest moves higher in interest rates and the U.S. dollar. We're not surprised to see some pullbacks on the path higher for gold. Looking over the medium term, we see support for gold in both a bull or bear case macro scenario, as we expect nominal interest rates to be lower-for-longer under both scenarios.

In the bull case, we would expect to see a faster roll out of a vaccine and a faster reopening of the global economy, which could drive inflation due to pent-up consumer demand. In a low nominal interest rate environment, growing inflation will drive negative real rates, which we believe will be supportive for gold. In the bear case, a vaccine is slower to roll out, waves of the virus continue over the medium term and the global economy takes longer than expected to get back to normal. Under that scenario, we expect to see continued support via fiscal and monetary policy, and generally higher macroeconomic risks, which we also believe will be supportive for gold.

With the positive macro background for gold in mind, this sector has started to attract interest from a wider range of generalist investors. The gold producers have supported that interest by focusing on capital and operating discipline, which is expected to support free-cash-flow generation and lead to dividend growth.

As signals on the outlook for precious metal prices we continue to watch:

- Global fiscal and monetary policy
- The shape of the yield curve
- Inflation indicators
- Global macro data, pandemic data and political/social developments

Regional economic views

Canada

- Significant improvement in Canada's consumer fundamentals and ultra-accommodative fiscal and monetary measures are positive developments.
- Canadian real GDP growth is projected to average +4.1% over the forecast horizon.

With the easing of COVID-19 containment measures, the Canadian economy experienced (as expected) a solid rebound over the third quarter. The recovery has so far been particularly impressive on the consumer front, with retail and wholesale trade sales fully recovering the ground lost during the lockdown. At first glance, it might be tempting to question the sustainability of this speedy recovery. After all, aren't Canadian households heavily in debt?

With a debt-to-disposable-income ratio that stands at 167%, Canadian households are deep in debt. However, the fact remains that consumer fundamentals are now more solid than they were before the recession, owing to two key developments.

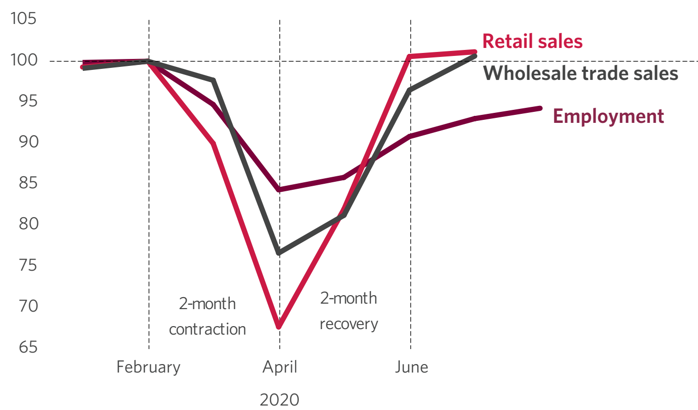
First, just like in the U.S., the hit on workers' compensation in Canada has been more than offset by the rise in government transfers, leading to a substantial increase in household disposable income. When combined with the forced consumer retrenchment just experienced, the end result has been a sharp increase in the household savings rate. At 28%, it currently stands at the highest level on record. This represents massive consumer firepower that can potentially be unleashed when concerns about the pandemic start to dissipate and life returns to normal.

Second, consumer fundamentals have also been improving significantly because of the sharp drop in interest rates delivered by the Bank of Canada. In only three months, the debt servicing ratio of Canadian households has dropped from an all-time high of 15% of disposable income to 12.4%. This amounts to the biggest and fastest drop in the household debt servicing burden on record.

Given the significant improvement in Canada's consumer fundamentals and also considering the ultra-accommodative measures taken by fiscal and monetary authorities, Canadian real GDP growth is projected to average +4.1% over the forecast horizon. While containment measures have recently been tightened in some parts of the country, we don't think this is enough to put Canada's economic recovery in jeopardy.

Canada's V-shaped recovery

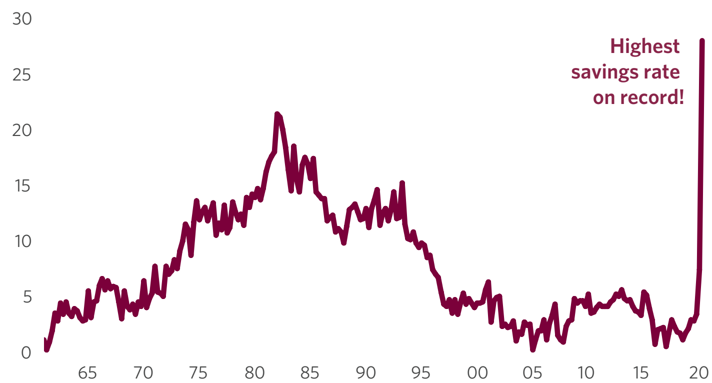
Canadian coincident indicators (start of recession = 100)



Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

Massive consumer firepower

Canadian households savings rate (%)



Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

United States

- Household disposable incomes are still up +6% six months after the contraction began—not what typically happens during a recession.
- Our view remains that the U.S. economy will experience a V-shaped recovery, with real GDP growth projected to average +3.9% over the forecast horizon.

The recession just experienced in the U.S. was like no other, with a very severe and very rapid contraction in economic activity. This was the result of effective lockdown measures and mobility restrictions put in place to slow the pandemic. It qualifies as a consumer-led recession, with consumer spending accounting for the largest chunk of the contraction in real GDP. What makes it unique, however, is the fact that there was no contraction in household disposable incomes. After six months, this reading is still up by +6%. Needless to say, this is not what typically happens during recessions. How is this possible? The reason is simple—the hit on worker compensation (i.e. caused by job layoffs) was more than offset by a massive rise in government transfers.

With fast-rising disposable incomes and forced consumer retrenchment, the U.S. savings ratio shot up to its highest level in 75 years and now stands at +17.8% of disposable income. Such a surge in the savings ratio is very rare. The last time we saw a consumer retrenchment of similar proportions goes all the way back to the Second World War (WWII). Back then, the end of WWII allowed for a substantial increase in consumer spending. In fact, the strongest yearly consumer spending growth numbers on record were recorded in 1946.

Obviously, the fact that the U.S. COVID-19 curve still hasn't been successfully flattened remains a source of concern. This will likely keep consumers sidelined a while longer with saving rates remaining unusually elevated. However, any breakthrough on the medical front relating to the COVID-19 pandemic would allow for a sharp decline in saving rates and provide a big boost to consumer spending.

For this important reason, and because of the bold measures taken by U.S. monetary and fiscal authorities, our view remains that the U.S. economy will experience a V-shaped recovery. U.S. real GDP growth is projected to average +3.9% over the forecast horizon.

With inflation projected to run well below target, the Fed will keep its ultra-accommodative policy stance in place over the whole forecast horizon. Its adoption of an Average Inflation Targeting (AIT) policy framework implies that it will anchor short rates near zero. It will also aim for new government borrowing costs to be significantly lower than the effective borrowing cost by adjusting its purchases of debt securities. This also implies continued debt monetization and a fast expansion of its balance sheet. The Fed is now targeting easy financial conditions and a weaker U.S. dollar is part of the equation.

Europe

- Our forecast calls for +3.8% average real GDP growth in the eurozone, comparable to what we're forecasting for the U.S.
- Eurozone banks have significantly increased their lending to non-financial corporations as well as their purchases of eurozone government bonds.

Three months ago, one of the key takeaways of our quarterly forecast was that the eurozone would experience a fast recovery owing to a strong policy impulse and the elimination of mobility restrictions. Is this forecast at risk now that the number of active COVID-19 cases is trending higher across the eurozone? Our forecast remains on track for two reasons.

First, we're accounting for the fact that testing capacities have increased considerably since the first outbreak. In the eurozone, the number of daily COVID-19 tests has increased from roughly 100K in March to approximatively 500K tests per day in September. When the number of active cases is corrected for this distortion, we find that the second wave is not yet remotely as bad as the first one.

The second reason to remain upbeat about the eurozone's growth prospects relates to the size and composition of the ECB's balance sheet. In contrast to the Fed, the ECB has primarily been expanding its balance sheet by extending its lending to eurozone banks. Why is this so important? The TLTRO I and TLTRO II lending schemes were only used by euro banks to clean–up their balance sheets (i.e. refinancing old ECB loans at cheaper costs). Things are different this time around, with eurozone banks significantly increasing their lending to non-financial corporations as well as their purchases of eurozone government bonds. While the additional bank support to non-financial corporations was absolutely needed, the elaboration of the scheme to rescue eurozone governments is the key innovation here.

In essence, the ECB found a way to eliminate the national limits determined by capital keys[5]. The ECB is now indirectly monetizing most of the new government bond issuance by lending to euro banks at a negative rate and having them do most of the government bond buying. When combining both the ECB's and the eurozone banks' purchases of government bonds, we find that 70% of the new debt issued has so far been monetized, with more support going to fiscally-challenged countries. In short, the ECB found a way to eliminate the risk of a government debt financing crisis in the eurozone. This is not trivial.

In light of the developments on the monetary policy front, and accounting for the still-to-come fiscal impulse associated with the EU recovery fund, our forecast calls for +3.8% average real GDP growth in the eurozone. This is an economic recovery comparable to the one we're forecasting for the U.S.

China

- China's recovery is beating consensus expectations.
- The consumer is becoming China's growth engine.

China's recovery has continued to surpass consensus expectations on the upside since our last *Perspectives* forecast highlighted this likelihood. Since China is not facing a COVID-19 outbreak nor imposing major mobility restrictions, large infrastructure and monetary stimulus continues to magnify the post-lockdown recovery—which should now be labelled an economic expansion.

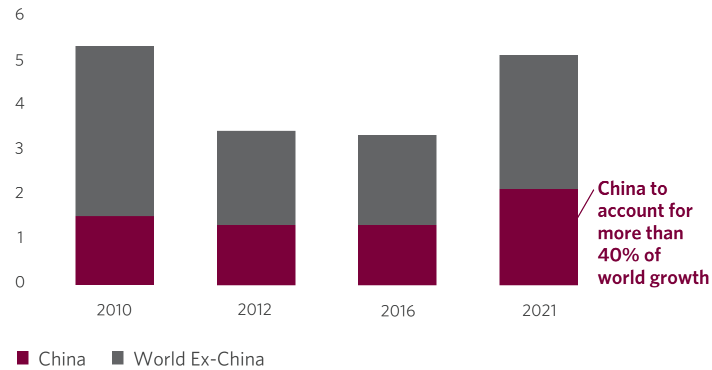
China is now in an environment that supports stronger consumption, with a self-reinforcing virtuous cycle between supply, demand, employment, and profits. This environment will also magnify the effect of upcoming stimulus.

While the stimulus impulse will soon peak, it should remain elevated given its size (comparable to 2012 and 2016 stimulus) and its increased focus on infrastructure (projects which are built gradually over time).

In addition, China is one of the few economies where the virus crisis has resulted in a large positive current account "shock". Prior to the global coronavirus crisis, China had a large international tourism trade deficit of about 5% of GDP, reflecting large net outflows of Chinese tourists. This deficit has melted and is unlikely to reappear in the foreseeable future. Instead, consumers are travelling and spending domestically, with the result that the current account shock amounts to a *de facto* stimulus.

China-led global recoveries

Contributions to World GDP Growth (%)



Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

In short, stimulus spillovers and the travel-driven current account shock will reinforce and magnify the virtuous cycle, and foster an environment that favours stronger consumption. The Chinese economy is expected to keep growing at an above-consensus average pace of 10% over the next four quarters.

Alternative scenarios

Sluggish global recovery (25% probability)

In this scenario, it takes longer to develop an efficient vaccine. The pandemic continues to intensify and spread, while policy response is largely inadequate. Cyclical and risky assets would face a significant correction. In addition, while the Chinese economic recovery remains on track, it comes with more limited spillovers for the rest of the world. The equity market rebounded rapidly after the recession, on hopes for a V-shaped recovery. As these hopes fail to materialze, equities and commodity prices would severely correct. Given that much of the global bond market is already in negative yield territory, only a few countries would have room for declining bond yields. Safe-haven assets like gold would surge.

Speedy return to normal (15% probability)

The best-case scenario calls for a vaccine that would become available well before spring 2021. Low risk aversion allows life to return to normal faster than anticipated and the world economy gets an extra boost from the consumer. The global yield curve remains very low and is inconsistent with a stronger-than-expected upturn in the economic cycle. Near 0% bond yields can only be justified by the very accommodative central bank policies. Facing rising inflation expectations, the bond market would start to test the central banks' commitment.

The equity market would continue to rally, and the sectors most dependent on reopening the economy would strongly outperform.

Scenario	Less Favourable	More Favourable
Sluggish Global Recovery (25%)	Global Equities High Yield Bonds Industrial metals	Gold U.S. Treasuries Swiss franc
Speedy return to normal (15%)	International bonds Canadian bonds U.S. Treasuries	Small cap equities Value equities Oil

Economic forecasts (next 12 months)

Region	Current GDP[7]	GDP - Consensus	GDP - CAM View	Current Inflation[8]	Inflation - Consensus	Inflation - CAM View	Policy Rate - CAM View
Canada	-13.0%[9]	4.0%	4.1%	0.1%	1.4%	1.3%	Near 0%
United States	-9.0%	2.0%	3.9%	1.3%	1.7%	1.7%	Near 0%
Eurozone	-14.7%	3.5%	3.8%	-0.3%	0.6%	0.7%	Near 0%
China	3.2%	9.2%	10.0%	2.4%	2.0%	2.0%	Cutting RRR[6]
Japan	-9.9%	0.9%	2.7%	0.2%	-0.2%	0.2%	Near 0%
World	-8.7%	5.1%	5.2%	2.0%	2.2%	2.4%	-

[6]Reserve Requirement Ratio
[7]Real GDP Growth (y/y %)
[8]Year/year %
[9]Implied (converted from a Q/Q basis)

Data as of September 2020
Source: Datastream, Bloomberg, CIBC Asset Management Calculations

[1] Personal Consumption Expenditures
[2] Facebook, Amazon, Apple, Netflix, Google
[3] as of September 30, 2020
[4] in hedged carry terms
[5] The capital of the ECB comes from the national central banks (NCBs) of all EU Member States. The NCBs' shares in this capital are calculated using a **key** which reflects the respective country's share in the total population and gross domestic product of the EU.