CIBC Asset Management

PERSPECTIVES

For the 12-month period beginning July 1, 2020

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Higher rewards, higher risks

A large segment of risky assets have already recouped nearly all of the ground lost during the March correction. Are markets ahead of themselves or will the global recovery be faster than generally expected? This is not an easy call, but we think the odds of a faster recovery are better than generally believed.

Asset class highlights

Equity: A liquidity-driven bull market in risky assets, including equities, is possible but could rest on shaky ground. Higher rewards come with higher risks.

Fixed Income: The U.S. Federal Reserve (Fed) is expected to work with an implicit target range for U.S. 10-year Treasury yields of around +0.5% to +1.15%. The U.S. government and U.S. non-financial corporations have heavy debt loads that need to be refinanced at a low cost with the issuance of longer duration debt securities. As a result, yield curve targeting is not an option.

Currencies: Relatively faster pandemic recovery in Europe and Asia versus the U.S. should be an important source of downward pressure on the overvalued U.S. dollar.

China: The world is experiencing a China-led recovery, with Chinese real growth projected to average +10.2% over the forecast horizon.

Multi-asset outlook

Asset class	Current June 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	0.29%	0.20%	0.60%
Canada 10-year government bond yield	0.53%	0.40%	1.05%
U.S. 10-year government bond yield	0.66%	0.50%	1.15%
Germany 10-year government bond yield	-0.46%	-0.35%	0.30%
Japan 10-year government bond yield	0.02%	-0.25%	0.25%
Canada 10-year real-return government bond yield	-0.08%	-0.20%	0.15%
Canada investment grade corporate spreads	1.58%	1.25%	2.05%
U.S. high yield corporate spreads	6.70%	5.05%	8.15%
Emerging market sovereign (USD denominated) bond spreads	433	250	600
S&P/TSX price index	15,515	14,500	17,000
S&P 500 price index	3,100	2,880	3,400
Euro Stoxx 50 price index	3,234	3,100	3,700
Japan Topix price index	1,559	1,450	1,700
MSCI Emerging Markets	57,480	57,300	67,000
U.S. Dollar/Canadian Dollar	1.3576	1.2800	1.3900
Euro/U.S. Dollar	1.1234	1.1000	1.2000
U.S. Dollar/Japanese Yen	107.93	102.00	111.00
U.S. Dollar/Offshore Chinese Yuan	7.07	6.65	7.15
Gold	1,781	1,600	1,900
Oil price, WTI (West Texas Intermediate)	39.27	30.00	55.00

Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

Asset class outlook

Global overview

Back to Normal?
At the current juncture, the dominant view remains that the world economy bottomed in the second quarter, but the global recovery will be slow to unfold. In sharp contrast, most risky assets have already recouped nearly all of the ground lost during the March correction. Are markets ahead of themselves or will the global recovery be faster than generally expected? This is no easy call, but we think the odds of a faster recovery are better than generally believed.

Of course, this is mainly conditional on how the global pandemic evolves. The risk is obviously for recurring waves of infections that force many countries to keep mobility restrictions in place for a lot longer, dragging the world economy down further. However, in our baseline projection, a vaccine is expected to come in the spring of 2021 and the world will experience a second wave outbreak next fall with relative ease. If this forecast materializes, the global economy may very well recover faster than generally expected because of the colossal efforts deployed by governments and central banks around the world.

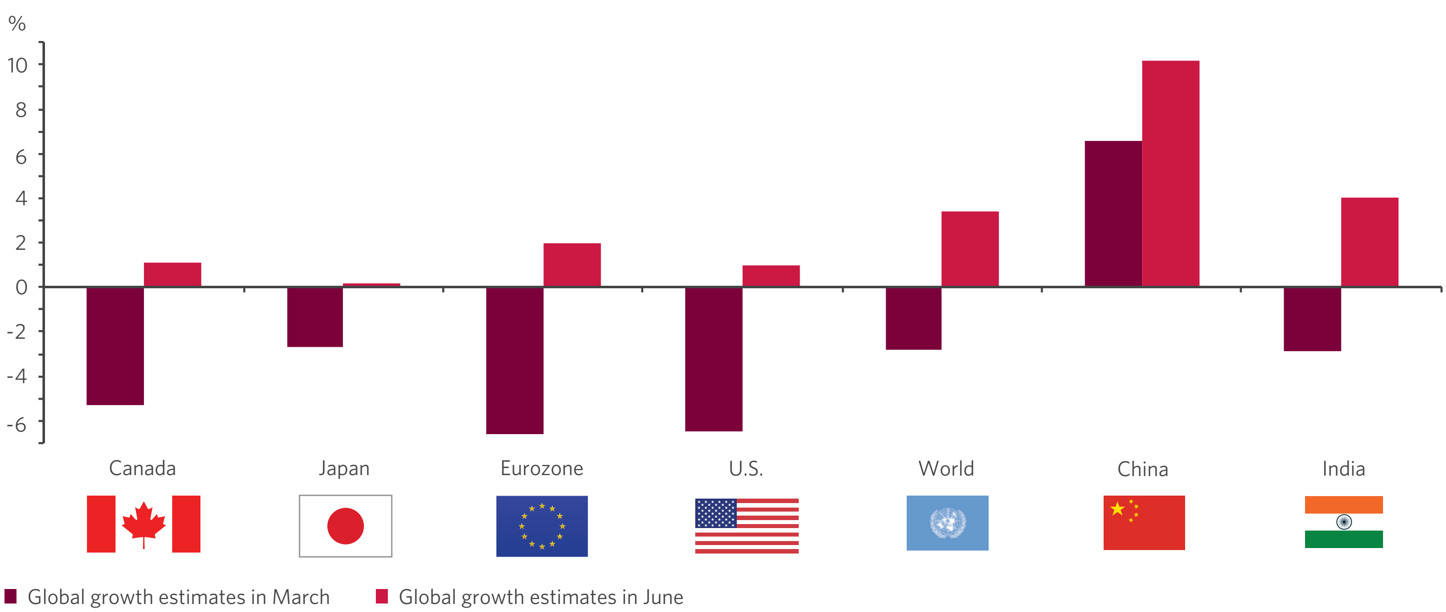
To be clear, the world economy has never before received such a high dose of policy stimulus. Overall, we are talking about the biggest-ever expansion of central bank balance sheets in many parts of the world. What's more, with policy rates converging to zero in the developed world, we are also talking about an unprecedented global policy regime shift. This new policy regime has three distinct features. First, central banks are now essentially committing to support governments by fully monetizing their fast-increasing borrowing needs. Central banks will be buying nearly all the new bonds issued by governments, allowing for much bigger fiscal deficits with low risk of a fiscal crisis.

This is just one of the key features of the new policy regime. Another important one is that asset purchasing programs have been redesigned to allow the central banks to keep a lid on borrowing costs for the public and private sectors by exerting more control over the shape of the yield curve and credit spreads. This is very important, as it allows governments and non-financial corporations to reduce their debt servicing costs by issuing longer duration debt securities. This way, bigger debt loads remain manageable.

Last but not least, central banks are committing to unlimited support to the banking sector through two distinct channels. First, the bigger the central banks' balance sheets become, the bigger the excess reserves in the banking system. This leaves banks cash-rich and better equipped to cope with adverse economic and financial conditions. Second, commercial banks can get even more help from central banks via lending schemes designed to provide long-term funding at attractive conditions. This is all very important, as it substantially reduces the risk of a banking crisis.

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 +3.4%. This assumes that the global pandemic doesn't take a turn for the worse.

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



Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

Global strategy

A liquidity-driven bull market?

The economic recovery after the 2008 financial crisis was long and sluggish. Despite the weak economic outcome, the equity market had a very strong bull market over the following 12 years. Accommodative monetary policy, with falling bond yields and quantitative easing, supported the market. As it turned out, the Fed had limited success in reflating the economy, but great success at reflating financial assets. With all the policy stimulus coming as a result of the COVID-19 pandemic, could we be at the onset of another liquidity-driven bull market?

The message the market is sending is loud and clear. Equity markets, high yield spreads, emerging market bonds and commodities have substantially rebounded over the last three months. Markets are forward looking and may be expecting, as we do, a quick economic recovery. So far, the reopening is proceeding with a limited and controlled second wave of infection. Any renewed outbreak is expected to be met with localized lockdown, which should not stop the ongoing recovery. At this juncture, the harsh reality is that the virus outbreak has not yet been fully stopped and the global economy is still in the early stages of recovery. As such, the most likely culprit for the market optimism is the abundance of liquidity provided by central banks.

Given the severity of the economic downturn, and the massive hit to the unemployment rate, central bankers will likely think twice before raising interest rates. In fact, Jerome Powell, chair of the Federal Reserve, said they are "not even thinking about *thinking about* raising rates". Policy rates of 0% will be with us for some time, and will likely influence returns in financial markets for years. Asset purchasing programs pushed bond yields near 0% and will keep them at these low levels. Nevertheless, expected returns on government bonds are unattractive. The "search for yield", a major theme of the last 10 years, may return for another round.

While risk assets remain supported by liquidity, we also have to consider the risks. Our expectations are for a V-shaped economic recovery, but what happens on the other side of the V is still unclear. Trend growth could remain challenged after the COVID-19 recession. Globalization was already in retreat and the pandemic will likely accelerate the trend toward protectionism and populism. The crisis will leave most governments with high levels of debt.

Geopolitical tensions have been put aside, as there are strong incentives to avoid confrontation in the middle of this historic crisis. But the U.S.-China trade war has been postponed, not abandoned. Approaching the elections with fading support, Trump will become more unpredictable and may try to mobilize his base with attacks on China. In other words, a liquidity-driven bull market is possible but would stand on shaky ground. Higher rewards come with higher risks.

Global equity markets

The rise of Europe?

After a down and up roundtrip of historically high amplitude and speed, equity markets are left with slightly cheaper valuations than before the COVID crisis. In a context of lower interest rates, higher valuation would, in fact, be supported. The question is what will the earnings be in the lower half of the P/E ratio. Corporate profits will definitely take a hit as a result of the global lockdown measures. But if our economic outlook plays out as expected, they may well recover even more rapidly than the economy. Earnings are driven by two main factors: economic activity and profit margins. The impact of the former is simple: a V-shaped economic recovery should lead to a V-shaped recovery in revenues. The latter is more complex.

Profit margins have cyclical fluctuations as well as a long-term trend. The cyclical fluctuations are related to the operational leverage companies have because of their fixed costs—this generally follows economic growth. The long-term trend is driven mostly by labour costs and interest rates. As a result of the lockdown, most companies have had to find ways to work with reduced staff. As they reopen, many will take the opportunity to reevaluate their business. The unemployment rate will remain high for some time, giving little bargaining power to the work force and limiting the rise in labour costs. Furthermore, the acceleration in adopting new technologies could provide productivity gains. However, those positive gains will face the negative consequences of rising trade tariffs and political pressure on corporations to spread more of their wealth if the rest of the population is struggling.

One highlight of our economic outlook is that the eurozone will outgrow the U.S. There are a number of reasons behind this outperformance. First, the European response to the virus outbreak was more successful in flattenning the curve. Europe might have initially been slow to recognize the extent of the problem, but once they did the results have been positive. Importantly, European countries did not reopen their economies prematurely, as the U.S. did. Second, the monetary and fiscal policy measures in Europe have been powerful and are expected to be effective. This is not to say they will be ineffective in the U.S., but Europe definitely overachieved compared to its own standards. Ineffective policies were one of the main drivers of underperformance for European equities for a long time. Meanwhile, the U.S., the bastion of free enterprise, enjoyed superiority in terms of economic flexibility and corporate profits. As a result of market underperformance, the valuation of European equities has become quite cheap relative to the U.S. However, as long as the U.S. had a growth advantage, that was justified. Going forward, Europe may well benefit from stronger growth, more effective policies and cheaper valuation.

Global bonds

In the last edition of *Perspectives*, we concluded that the Fed would be using its asset purchase programs to cap the upside on Treasury and corporate bond yields. This represents an effort to alleviate funding pressures on the public and private sectors. To be clear, the U.S. Federal Reserve has not yet officially adopted a Yield Curve Control (YCC) policy as in Japan or Australia. However, U.S. monetary authorities have already increased their influence on the shape of the yield curve. Case in point—since late March, U.S. 10-year Treasury yields have been extremely well-behaved, trading at around +0.6%. This is in line with our expectations.

In our view, it's just a matter of time before the Fed officially adds a Yield Curve Control policy to its fast expanding tool kit. Before doing so, however, it has to appropriately set its YCC policy parameters and this is easier said than done. At a minimum, the targeted yield curve will have to be steep enough to limit the net selling of Treasuries by foreign holders. Ideally, it would be steep enough to get foreigners to turn back into net buyers to help finance the Treasury's huge deficit. A positively sloped yield curve is also needed to limit the negative impact of ultra-low interest rates on the profitability of U.S. commercial banks.

However, the Treasury yield curve also has to be just flat enough to keep public and private sector funding costs low. This means that what happens to the spread between corporate bond yields and Treasury yields will be a determinant. Too much widening in credit spread could force the Fed to temporarily target a much flatter curve.

In short, controlling the shape of the yield curve promises to be a difficult balancing act for the Fed, as it will be aiming at a moving target. For this reason, the Fed is expected to work with an implicit target range for the U.S. Treasury yield curve with a lower band at +0.5% and an upper band at +1.15% for U.S. 10-year Treasury yields. Yield curve targeting is not an option. The U.S. government and U.S. non-financial corporations have very heavy debt loads that need to be refinanced at a low cost via the issuance of longer duration debt securities.

While yield curve control isn't yet part of the Bank of Canada's tool kit, Canadian monetary authorities will need to seriously consider it. The Canadian government's debt load is rising fast and the private non-financial sector is already stuck with a heavy debt burden. Canadian federal government 10-year yields are projected to range between 0.4% and 1.05% over the forecast horizon.

Currencies

U.S. Dollar

Despite a recent bout of broad-based weakness, the U.S. dollar bull market, in place since 2011, still hasn't been seriously challenged. Looking forward, however, we think that conditions could finally be in place for the bull market to start being seriously challenged.

For one thing, with the rate cuts delivered by the Fed, the U.S. dollar no longer has an interest rate advantage. For another, the greenback has appreciated by more than 50% on a trade-weighted basis over the last decade. As a result, it now qualifies as deeply overvalued. This is an important source of concern for U.S. monetary authorities and partly explains why the Fed has been flooding the world with U.S. dollar liquidity. Thanks to the Fed's colossal efforts, the greenback will be under intensifying pressure in 2H 2020.

Consider also that the projected global economy recovery is not expected to be led by the United States—this is not typical at all. Asian and European countries are so far having a lot more success in flattening the COVID-19 curves (i.e. reducing the number of active cases) than the U.S. This makes a big difference, as mobility restrictions can be reduced or removed more quickly, allowing for a faster economic recovery. Relative developments on the cyclical front between the U.S. and the rest of the world should also be an important source of downward pressure on the U.S, dollar.

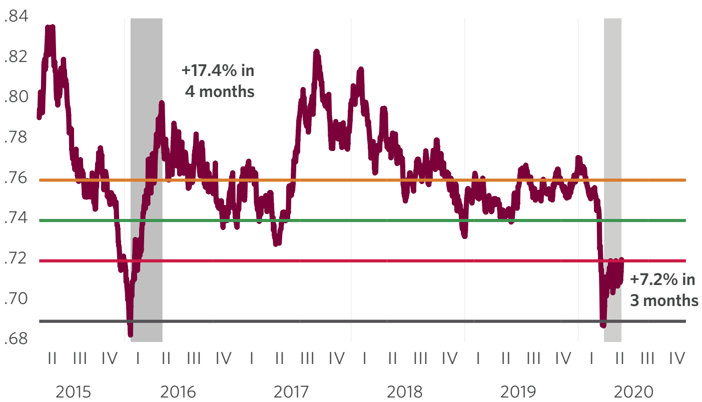
Canadian Dollar

In terms of duration and amplitude, the current bout of Canadian dollar strength increasingly resembles early 2016. Back then, the Canadian dollar bottomed below 69 cents but staged a powerful comeback, appreciating by +17.4% in just four months. While momentum is a bit weaker this time around, the Canadian dollar has managed to recover more than 50% of the ground lost during the financial storm that hit the world last March. To be fair, the recovery in oil prices has been more muted this time around and, looking forward, there is probably less upside than in 2016. U.S. suppliers are expected to come back on line rather quickly and cap the upside for oil prices.

The story is different for USD funding/credit conditions. U.S. credit spreads have substantially narrowed since the Fed deployed colossal efforts to restore U.S. dollar funding conditions globally. It's important to emphasize that what happens to U.S. credit conditions plays a key role in the determination of the Canadian dollar's value. This is because a big chunk of the heavy debt load of Canadian non-financial corporations is denominated in U.S. dollars. When the U.S. credit market freezes up like it did last March, Canadian businesses take a severe hit, as they lose access to their most important source of U.S. dollar funding. The narrowing of U.S.

credit spreads since March largely explains why the Canadian dollar has been doing better against the greenback. Looking forward, there is room for U.S. credit spreads to narrow further and the Canadian dollar to gain more ground against the greenback—even if oil prices don't rise a lot from this point. Under these conditions, the Canadian dollar will likely trade between 0.72 and 0.78 US cents (or 1.28 to 1.39 USDCAD) over the forecast horizon.

CADUSD: A replay of 2016?
CADUSD bilateral exchange rate & key technical levels



Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

Euro
Looking at relative fundamentals, it's hard to see why the euro has been trading in undervalued territory against the U.S. dollar for so long. One potential explanation could be that this corresponds to a period where the European Central Bank (ECB) was expanding its balance sheet faster than the Fed. Although this isn't just a coincidence, it's not because of the ECB's balance sheet expansion per se, but because of the way it was expanded. Between 2015 and 2018, the ECB was buying a lot of government bonds—much more than new government borrowing needs. Given that eurozone banks were not willing to sell much of what they held to the ECB, it had to buy a lot of EU government bonds from the rest of the world to fill the gap. For all these years, net bond outflows exerted downward pressures on the euro.

The story is different now. The ECB is buying a lot more government debt securities, but only to match new government borrowing requirements. This eliminates the downward pressure on the euro from net bond selling from the rest of the world. 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 last edition of *Perspectives*, we argued that the convergence of policy rates to zero in the developed world and the Fed's efforts to pump U.S. dollar liquidity into the global financial system would lead to a significant drop in global FX volatility. That is exactly what has happened and it's most apparent when focusing on the Japanese yen. After the flight to safety in late March, 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 lower FX volatility as it involves: (1) full debt monetization, implying that the central bank's government bonds purchases will be 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 financial markets. In such an environment, the USDJPY bilateral exchange rate should also remain well-behaved, fluctuating between 102 and 111.

Commodities

Oil prices went on a wild ride in the second quarter, falling briefly into negative territory in April but moving back towards $40/barrel in mid-June and extending into July. At this point, we've seen improvements in both the supply and demand pictures, with U.S. demand almost recovered from pandemic-induced depths. Overall, we're fairly optimistic about the outlook for stable to higher oil prices in 2021 and beyond.

U.S. gasoline demand, which stood at about 10M barrels/day pre-COVID but dropped to 6M, has now rebounded to 9.3M, bringing demand back by over 90%. China, which is about 3 months ahead of the U.S. and Europe in its pandemic progression, is back to pre-pandemic levels for energy demand; we're also seeing a rebound in demand for other commodities in China. Of course, this is an easier feat to accomplish in an economy largely mandated and controlled by a central government. For diesel fuel (U.S. numbers), which incorporates demand usage from boats, planes, trucks and some cars, demand never declined to the same extent as gasoline. Current numbers show usage at about 4.2 million barrels/day versus 5 million pre-COVID.

On the supply side, the OPEC meeting on June 6 extended existing production cuts (-9.7 million barrels/day) by another month, to the end of July. As it now stands, that cut will be reduced to -7.7 million in August and that level will continue to the end of 2020. In 2021 and extending to April 2022, the cut will be further reduced to -5.7 million. In contrast to the drama at the last OPEC meeting, member countries seem to have coordinated strategy before the meeting, and it concluded with a relatively straightforward announcement. OPEC will be monitoring member compliance on a monthly basis, as members Iraq and Nigeria have not been meeting agreed-upon reduction levels. These extended cuts will offset new supply that Canadian and U.S. producers brought back in May and June as prices rallied and production was once more at least a break-even proposition. Recent talks with oil company management confirm that almost every energy company has resumed some production in the last month or so to cover cash costs.

Overall, the balance is currently swinging in favour of increasing demand. Of course, the situation is very fluid with a number of unknowns. An unchecked resurgence of COVID in the U.S. could quickly reduce demand. On the supply side, we look at Libya as just one situation that could dramatically alter the supply situation. Libya's civil war has reduced its contribution to world supply by about 1 million barrels/day since December 2019. Any resolution of that situation, as well as any non-compliance from other OPEC+ members, could mean a spike in supply and potentially lower oil prices.

Gold

Looking around the world today we see a lot of macro risks and economic factors that remain supportive for the gold price over the medium term. On the geopolitical side, there is growing pandemic risk, tension between the U.S. and China, Hong Kong risk and growing social unrest in the U.S. as we head into an election cycle. On the macroeconomic side there are negative real interest rates, ongoing quantitative easing and aggressive government stimulus programs. Combined, we think the geopolitical factors and macroeconomic outlook remain supportive for gold over the medium term.

In fact, when we look forward from here, we believe that both the bull and bear case scenarios for the global economy could be constructive for the gold price. When we consider the macroeconomic bull case, we believe this scenario implies a faster-than-expected reopening of the global economy and things getting back to normal. Under the bull scenario, we believe there could be pent-up consumer demand that drives inflation, which in a low interest rate environment would lead to negative real interest rates. We believe this scenario would be supportive for gold. When we consider the macroeconomic bear case, we believe this scenario implies ongoing pandemic risks and a slower-than-expected reopening of the global economy. Under the bear case, we would expect to see ongoing quantitative easing and lower interest rates for longer, which also should be supportive for gold.

Gold has recently moved through $1,800/oz, having appreciated by 23% from lows of $1,470/oz in mid-March. We think there is more to come and that the price could exceed the highs reached post-Global Financial Crisis, when it peaked at $1,900/oz in September 2011. If there are near-term potential headwinds for the gold price we think they could come if central banks sell gold to shore up currency reserves, if a general risk-on sentiment takes hold in global markets or if we see gold ETF outflows.

Regional economic views

Canada

Back on its feet as fast as possible

- The Bank of Canada has adopted an ultra-accommodative policy stance and will continue to provide ongoing support to Canadian banks.
- Canadian real GDP growth is projected to average +1.1% over the forecast horizon.

Due to COVID-19 containment measures and the sharp correction in the price of oil, the Canadian economy experienced a severe contraction during the second quarter. With the virus infection rate now broadly under control and significant efforts deployed by Canadian monetary and fiscal authorities, our baseline scenario calls for a faster recovery than generally projected.

Like many other central banks, the Bank of Canada had no choice but to bring out the big guns. After cutting its policy rate to the lower bound, it started to massively expand its balance sheet, implementing an array of measures to limit the damage to the Canadian financial system.

This was not optional, as Canada entered the COVID-19 recession with a much heavier private sector debt load than it did during the Great Financial Crisis. Heavy debt loads are fine when the good times roll, but can potentially become a very big problem during economic recessions. Needless to say, Canadian monetary authorities were and still are fully aware of this. As such, it didn't take long for the Bank of Canada to adopt an ultra-accommodative policy stance. The Bank of Canada is predicting a significant increase in non-performing loans at the end of the year as loan deferrals come to an end. As a result, we expect it will continue to provide ongoing support to Canadian banks.

The Bank of Canada's aggressive policy response ultimately aims to put the Canadian economy back on its feet as fast as possible. By committing to purchase at least $5 billion/week of a vast array of assets until the economic recovery is well underway, it aims to keep borrowing costs low across the whole maturity spectrum for all economic agents (i.e. the government, households and non-financial corporations). The Bank of Canada policy actions and fiscal support of close to 12% of GDP aimed at mitigating households' and firms' income losses are substantial. As a result, we believe that the Canadian economy will recover more rapidly than currently projected by consensus. Canadian real GDP growth is projected to average +1.1% over the forecast horizon.

United States

A V-shaped recovery still likely

- U.S. real GDP growth is projected to average +1.0% over the forecast horizon.
- U.S. non-financial corporations will likely restore profitability faster than in any other recession.

Virus containment measures caused the U.S. economy to experience a sharp contraction in economic activity over the second quarter. The fact that the U.S. COVID-19 curve still hasn't been successfully flattened obviously remains a source of concern. However, our view remains that the U.S. economy will experience a V-shaped recovery because of the bold measures taken by U.S. monetary and fiscal authorities.

In many ways, the U.S. economy is on more solid footing this time as compared to 12 years ago at the time of the Great Recession. The Fed's policy response back in 2008 was a lot slower and more modest than the current one. As measured by the monetary base-to-GDP ratio, the Fed's current monetary impulse is almost three times bigger than the one delivered in 2008-09. It's not just bigger, the delivery has been a lot faster.

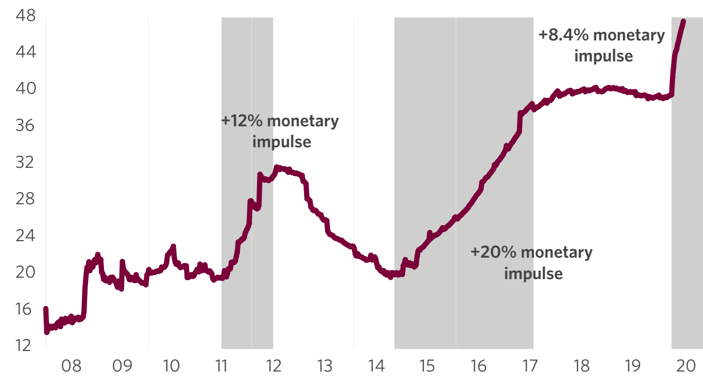
This time around, the story is also very different from the perspective of U.S. commercial banks. While the U.S. economy has undeniably taken a very severe hit, banks still have healthy balance sheets with plenty of highly liquid quality assets (HQLAs), thanks to the expansion of the Fed's balance sheet. The excess reserves that commercial banks hold at the Federal Reserve amount to 16% of total bank assets or $3.3 trillion. This is more than enough to cope with a significant rise in loan defaults.

Another distinction is that U.S. non-financial corporations are better equipped to cope with the shock on profitability. Thanks to efforts deployed by the Fed, they have had no problem getting the liquidity needed to weather the storm. What's more, the adjustment in labour costs to the contraction in economic activity has been instantaneous—the total wage bill shrank just as much and just as fast as the U.S. economy. Because of this, it will be possible for U.S. non-financial corporations to restore profitability faster than in any other recession.

BOTTOM LINE: For all the reasons enumerated, we believe the U.S. economy will recover more rapidly than generally expected. U.S. real GDP growth is projected to average +1.0% 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.

The ECB's very fast policy response

ECB total assets to GDP ratio (%)



Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

Europe

Stronger recovery than in the U.S.

- The ECB has finally found a way to strengthen banks' profitability and enhance their ability to lend to the real economy.
- Our forecast calls for +2.0% average real GDP growth in the eurozone, stronger than the United States.

The economic downturn in the eurozone was probably deeper than we projected three months ago. According to the ECB, all the ground lost should only be recouped by late 2021, not sooner. However, we believe there are good reasons the eurozone economy will experience a faster recovery.

Just like the U.S. Federal Reserve, the ECB was very quick to bring out the heavy artillery. Since March, the ratio of ECB total assets to GDP has increased by +8.4%. However, this time around, it's not just about the sheer size of the ECB's balance sheet expansion, it's also the efficiency of the measures taken. It's very important to understand that the ECB's new policy regime is no longer just about policy rates and is much better designed for the task at hand—jumpstart the eurozone's moribund economy. The measures employed now involve implicit yield curve and credit spread control policies, public and private debt monetization, negative policy rates with a two-tiered system for reserve remuneration system as well as a redesigned bank lending scheme. These are definitely some big guns.

While the ECB will be buying public and private sector debt securities like never before, it's the new TLTRO bank lending scheme that really qualifies as a game changer. Until now, the bank lending schemes elaborated by the ECB never met the targeted objective—that is, to stimulate bank lending to the real economy. Instead, the TLTRO I and TLTRO II lending schemes were essentially used by eurozone banks to patch-up their still-messy balance sheets. In sharp contrast, the new and improved TLTRO III has led to record take-up by eurozone banks. Combined with the sharp increase in excess reserves in the banking system owing to the overall expansion of the ECB's balance sheet, the large take-up of the latest TLTRO round is providing a sizeable liquidity buffer to eurozone banks. What's more, it provides a substantial boost to their profitability, as negative rates have been transformed from a net tax on the banking sector into a net subsidy.

Accounting for all aspects of its new ultra-accommodative policy regime, the ECB finally found a way to strengthen banks' profitability and enhance banks' ability to lend to the real economy. This should facilitate the cyclical revival of the eurozone economy. Our forecast calls for +2.0% average real GDP growth in the eurozone—a stronger economic recovery than in the United States.

China

The world's growth engine once again

- COVID-19 created less economic damage in China as compared to other regions and will be a smaller growth impediment looking forward.
- The world is experiencing a China-led recovery, with Chinese real growth averaging +10.2% over the forecast horizon.

China was the first country hit by COVID-19 and the first economy to embark on the road to recovery. In our view, China's recovery will surprise on the upside with double-digit real GDP growth. If our forecast materializes, China will be the world's growth engine, accounting for more than 60% of the +3.4% growth rate projected for the world economy.

Unlike other major economies, the virus outbreak in China was not widespread and was contained much more rapidly. As a result, the virus has created less economic damage than in the rest of the world and will be a smaller growth impediment looking ahead. Reflecting this, supply-side data have already mostly renormalized and confidence has picked up. Demand-related data has lagged but is also improving.

The gradual ease of mobility restrictions abroad will also be an important tailwind for Chinese manufacturers. While Chinese exports have remained at depressed levels, the country breakdown shows that the magnitude of contraction is proportional to the intensity of lockdowns in destination countries.

Stimulus will also support the recovery. In our last *Perspectives* edition, we pointed out that China would have to deliver stimulus—and it did, unveiling one of the largest fiscal packages among emerging economies. One distinctive feature is the inclusion of infrastructure investment of almost 2% of GDP. Infrastructure has the highest multiplier within the policy toolbox and China has a good track record of delivering this type of stimulus (2009, 2012 and 2015-16). Financing and production data suggest the stimulus is already working.

Sizeable monetary policy stimulus was also implemented. Key financing rates and credit spreads are at historical lows. Companies are increasingly financing themselves via debt issuance (less expensive than bank loans) and extending duration. This means debt-servicing is becoming a smaller and less uncertain burden.

In short, the world is experiencing a China-led recovery, with Chinese real growth averaging +10.2% over the forecast horizon.

Alternative scenarios

Protracted Recovery (40%)

Despite all the accommodative measures taken by governments and central banks, the global economic downturn proves to be deeper and longer lasting than projected in our central scenario. Virus containment measures need to be implemented for longer than initially planned and prove to be more damaging for the world economy. The vaccine takes longer to be developed. The global economic recovery ends being more U-shaped than V-shaped.

In this scenario, there is very little room for an improvement in global financial conditions. The recovery in risk assets comes to a halt with a potentially important setback, leaving global investors stuck in an environment of heightened uncertainty and elevated market volatility. Global bond markets would be expected to shift into rallying mode, but with limited downside for bond yields, given already low yield levels. Despite the Fed's efforts to provide U.S. dollar liquidity to the rest of the world, global U.S. dollar funding pressures continue, keeping the U.S. dollar well supported. In this environment, the bull run in the price of gold would still have legs.

Accelerated Recovery (10%)

In this relatively more upbeat alternative scenario, the efforts deployed by monetary and fiscal authorities around the world are successful in limiting the economic fallout from the coronavirus. Also, and just as important, the social lockdowns globally enacted are successful in flattening the curve and containing the virus. This is the best case scenario, with a vaccine being developed well before the spring of 2021 and low risk aversion that allows life to return to normal faster than anticipated in our baseline scenario. In the context of a faster-improving global economic landscape, the recovery in risk assets would be more strongly supported, thanks to a rosier earnings growth outlook. A pullback in global bond markets would likely materialize, but the potential upside for global bond yields would be limited owing to heavier bond purchases by central banks. With abating global U.S. dollar funding pressures, the U.S. dollar would likely embark on a broad-based cyclical downtrend.

Scenario	Less Favourable	More Favourable
Protracted Recovery (40%)	Global Equities Industrial Metals High Yield Bonds	Gold U.S. Dollar U.S. Treasuries
Accelerated Recovery (10%)	U.S. Dollar Long-dated G10 Bonds	Global Equities Emerging Currencies High Yield Bonds Commodities

Economic forecasts (next 12 months)

Region	Current GDP[4]	GDP - Consensus	GDP - CAM View	Current Inflation[5]	Inflation - Consensus	Inflation - CAM View	Policy Rate - CAM View
Canada	-0.9%[6]	-1.0%	1.1%	-0.4%	1.1%	0.9%	Near 0%
United States	0.3%	-1.0%	1.0%	0.3%	0.9%	1.0%	Near 0%
Eurozone	-3.2%	-0.2%	2.0%	0.1%	0.4%	0.6%	Near 0%
China	-6.8%	8.3%	10.2%	2.4%	1.6%	1.9%	Cutting RRR[3]
Japan	-1.9%	-1.3%	0.2%	0.0%	-0.3%	-0.2%	Near 0%
World	-1.8%	0.7%	3.4%	2.4%	2.3%	2.1%	-

[3]Reserve Requirement Ratio
[4]Real GDP Growth (y/y %)
[5]Year/year %
[6]Implied (converted from a Q/Q basis)

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