CIBC Asset Management

PERSPECTIVES

For the 12-month period beginning April 1, 2021

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Roaring back to life

The global economy will enjoy its strongest growth on record over the next four quarters, as the recovery continues from the deepest recession since World War II. On the COVID vaccination front, herd immunity is finally within reach in a growing number of countries. Developed world governments also have an impressive arsenal still at their disposal due to the full cooperation of their respective central banks.

Asset class highlights

Equity: Equities in most countries are moderately but not extremely overvalued. Cyclical forces will likely push equities higher, but high valuation could limit potential gains.

Fixed Income: We continue to favour emerging market (EM) debt based on a number of factors including our upbeat forecast on commodities and China and our bearish USD long-term view.

Currencies: We expect the U.S. dollar downtrend to resume, given the global economic recovery, the Fed's policy rate anchored near zero and the adoption of Average Inflation Targeting (AIT) that implicitly targets a weaker U.S. dollar.

China: Consensus opinion is underestimating the strength of the foreign global demand that will benefit China. Historically, periods of strong global growth have been associated with positive economic surprises in China.

Multi-asset outlook

Asset class	Current March 31, 2021	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	0.22%	0.20%	0.65%
Canada 10-year government bond yield	1.56%	1.00%	2.15%
U.S. 10-year government bond yield	1.74%	1.25%	2.25%
Germany 10-year government bond yield	-0.29%	-0.45%	0.10%
Japan 10-year government bond yield	0.09%	-0.25%	0.25%
Canada 10-year real-return government bond yield	0.22%	-0.05%	0.55%
Canada investment grade corporate spreads	1.22%	1.40%	0.95%
U.S. high yield corporate spreads	3.30%	5.25%	3.15%
Emerging market sovereign (USD denominated) bond spreads	324	250	500
S&P/TSX price index	18,701	17,750	20,500
S&P 500 price index	3,973	3,700	4,350
Euro Stoxx 50 price index	3,919	3,750	4,350
Japan Topix price index	1,954	1,850	2,150
MSCI Emerging Markets	74,289	70,000	83,500
U.S. Dollar/Canadian Dollar	1.2562	1.219	1.282
Euro/U.S. Dollar	1.1730	1.160	1.230
U.S. Dollar/Japanese Yen	110.72	104.00	112.00
U.S. Dollar/Offshore Chinese Yuan	6.56	6.28	6.90
Gold	1,708	1,600	2,200
Oil price, WTI (West Texas Intermediate)	59.16	57.00	75.00

Source: Thomson Reuters Datastream, CIBC Asset Management Inc.

Asset class outlook

Global overview

Roaring back to life
Given the colossal efforts deployed by monetary and fiscal authorities around the world and a successful and accelerating global vaccination campaign, the global economy is expected to roar back to life. After experiencing its deepest recession since the Second World War, owing to the global pandemic and lockdown, the world economy is about to enjoy its strongest growth on record over the next four quarters (+7.8% average global real GDP growth between 2021Q2 and 2022Q1). This is certainly very good news.

Of course, our bullish global forecast is conditional on how the COVID-19 global pandemic evolves. From this perspective, there are good reasons to feel more upbeat. In many developed countries, the share of the population that have received a first vaccination is fast-rising and the number of active cases is increasing at a decelerating pace. In more and more countries herd immunity is within reach.

We're also very optimistic because of the impressive arsenal still at the disposal of governments. Around the developed world, governments have been able to deliver massive fiscal support because of the full cooperation of their respective central banks. This was made possible because most of the historically large fiscal deficits recorded since the start of the pandemic have been monetized—that is, central banks have been printing money to buy the heavy load of new debt securities issued by governments.

For the time being, fiscal policy leeway remains unconstrained. Monetary authority policymakers continue working hard to make sure that the fiscal situation remains under control. Faster economic growth and higher inflation are both required for governments to get their fiscal houses in order and monetary authorities are fully aware of this. As such, they will keep the global monetary policy stance ultra-accommodative through their joint policy actions. This means keeping borrowing costs ultra-low across the whole maturity spectrum. From that angle, it's too soon to take away the punch bowl, implying that global liquidity will remain abundant over the forecast horizon. Ample liquidity is an essential condition for keeping risky assets in rallying mode.

The reality for global investors, however, is that this very rosy world economy outlook is, to a large extent, already priced in to financial markets. More and more market participants are already starting to worry about the day central banks will start mopping the excess liquidity out of the global financial system. They're right. Eventually, there will come a time when there will be enough improvement on the fiscal front, as well as enough growth and inflation in the economy, to start to foresee a stabilization in the government's heavy debt load. When that time comes, monetary authorities will have to find a way to start draining excess liquidity without causing too much damage to economic and financial conditions. This promises to be a very difficult task. With a faster economic recovery and higher inflation projected for the U.S. than elsewhere in the developed world, the first central bank in line will surely be the U.S. Federal Reserve (Fed). However, the commitment of other central banks to cooperate with governments will also be increasingly questioned by investors. The pullback in the U.S. Treasury market and the greenback's comeback over the first quarter give us a taste of what we can expect over the forecast horizon—greater uncertainty for the economic direction and higher financial market volatility.

Global strategy

Rebalancing the bond risk premium
There are 4 key assumptions underpining over economic outlook. Those assumptions not only define our economic scenario but also have important implications for financial markets. First, a fast and efficient vaccination campaign will bring back life after COVID-19 and will remain effective against mutations. Second, we expect a strong economic rebound led by the consumer. Consumers have massive firepower, supported by helicopter[1] money from the government, a sharp increase in worker compensation on top of the excess savings already in hand, and low interest rates that are reducing the cost of debt. Third, monetary policy will remain highly accommodative and more fiscal support is expected. Fourth, inflation will return because of cost-push inflationary pressures, supply shortages, fast-rising energy prices and a strong FX(foreign currency) pass-through (in the event of U.S. inflation).

There are obviously a number of risks associated with these assumptions, but those risks fall within the scope of less-likely alternative scenarios. What's notable is that there is a fairly strong consensus around the expectations for the economic recovery. The key questions are not related to the economy itself but to financial markets, and one of the key questions is how much of this positive scenario has already been priced in?

Ignoring valuation for a moment, let's look at the cyclical factor. Our assumptions imply that the outlook for equities should be quite positive, but less positive for bonds. Equities typically do well during periods of economic expansion because earnings are strong and the appetite for risk supports high P/E ratios. Meanwhile, bond yields would rise on expectations of upcoming policy tightening. But the two are not independent, in the sense that rising bond yields could at one point choke the bull market in equities. At what point? The difficulty in answering this question is that there isn't really a "breaking point", a level in bond yields where equities would start to feel some pain. It's more a matter of perception by market participants, and subject to the "market mood", which can change depending on circumstances. What really matters when determining the impact of bond yields on equities are the prevailing conditions.

One thing to keep in mind is that rising bond yields are not necessarily bad for equities. What matters most is the spread between growth and interest rates. If growth rises faster than bond yields, at the margin this is positive for equities. Another point is that the outlook for bonds will be highly influenced by inflation expectations. Rising inflation pressures would typically lead to expectations of a tightening in monetary policy, in turn pushing bond yields upward. But central bankers have been very clear that they want more inflation and will look through temporary factors and even tolerate inflation above their target, formally (in the case of the Fed) or informally (in the case of the ECB). In other words, the policy reaction function has changed and we should therefore also expect a different relationship between inflation, bond yields and equities. As a result, we don't expect that rising inflation and bond yields will be a significant headwind for equities.

Turning our attention to the relative valuation of equities vs. bonds, we see that the picture has changed significantly over the past few months. While equities continued to rally, bond yields have been moving up across the world, in both developed and emerging countries. As a result, equities and bonds are now generally comparable on a valuation basis. Our main measure to compare valuation between the two is our multi-asset risk premium model. According to this model, equities still have a higher risk premium than bonds, which should be the case most of time because equities are riskier than bonds. However, when we adjust the risk premium of each asset class by its respective volatility, we see in developed countries, on a risk-adjusted basis, that bonds now offer a risk premium comparable to that of equities. There are exceptions such as the eurozone and Japan, where bond yields are still quite low. To be clear, we're not saying bonds are fairly valued. Bond yields are still below our long-term equilibrium. For example, in Canada at the end of March, 10-year government bonds were trading at 1.56%, while our long term target is 2.21%. What this means instead is that equities and bonds are now equally overvalued—equities are more overvalued than they were in the recent past while bonds are less overvalued.

Global equity markets

Cyclical forces and valuation in a tug of war

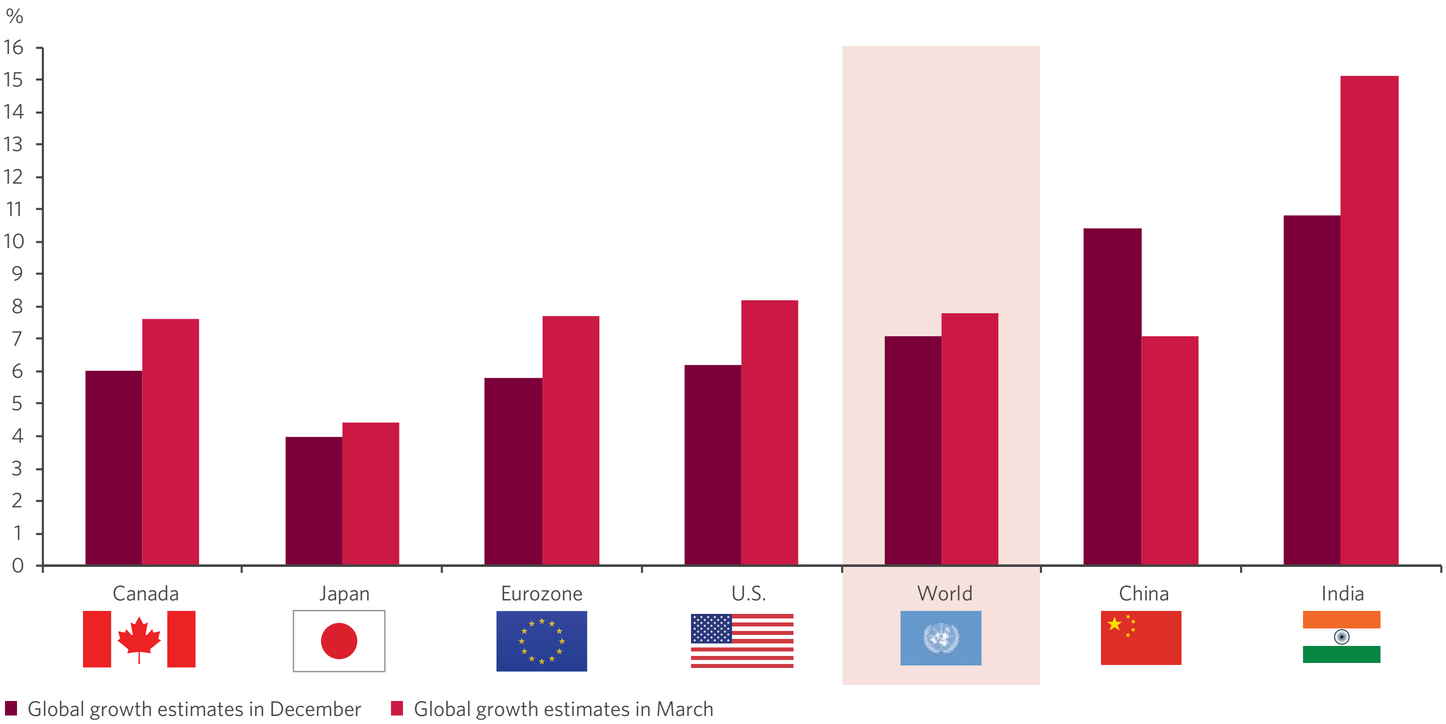
While the economic outlook may be quite supportive for equities, it seems that much of the good news has already been priced in. In a textbook economic cycle, following a recession, investors will start to anticipate the recovery before it actually happens. While realized earnings still remain depresed, forward earnings will rise well before trailing earnings and equity prices will move up rapidly on improving expectations. As such, P/E ratios based on trailing earnings would rise and could surpass their pre-recession levels, as prices rise while earnings don't. However, ratios based on forward earnings should be less influenced by the earnings cycle as prices and forward earnings both increase at the same time. Applying this logic to the current situation, this is where valuation could become a headwind—forward P/Es have already increased significantly. Basically, the market is not only pricing in a recovery in earnings, it's also expecting that earnings forecasts will need to be revised upward.

Earnings are expected to grow over the next 12 months by 22%, 30% and 45% respectively in the U.S., eurozone and Canada. Although that seems high at first glance, it's consistent with previous post-recession recoveries. The unprecedented nature of the current cycle makes it hard to predict earnings growth. Given the very strong expected rebound in economic activity, it's reasonable to expect a bigger-than-usual rebound in earnings. So there might be some room for upgrades to earnings forecasts. But as we just argued, this has already been priced in, so the bar is high.

The picture is relatively consistent across countries. Equities in most countries are moderately overvalued, but not to extreme levels. Over a long-term horizon (5 to 10 years), valuation is a key driver of returns. However, on a tactical basis (6 to 18 months), we think of valuation as a marginal driver of returns, unless it becomes very under- or over-valued. Equities are not there yet. In the current environment of very strong growth and extremely easy monetary policy, we can't rule out that valuation will continue to rise and reach extreme levels. Although it's possible, it's hard to make the case for equities if that case relies only on expensive valuation becoming more expensive—there have to be other factors. The most likely outcome is that cyclical forces will push equities higher, but high valuation will limit potential gains.

To stay on the valuation front, we've argued in the past that emerging equities were undervalued and much more attractive than U.S. equities, which were overvalued. However, the performance of the last few months has partially closed that gap. For example, since the last quarter of 2020, Korea, Taiwan and India are up by roughly 35%, all driven by higher P/E ratios. Those countries represent a bit more than a third of the emerging markets index (China makes up another third and all other countries comprise the remaining). Overall, emerging markets are up by nearly 70% since March 2020. The strength of commodity prices and the weakness of the USD will support cyclical markets, so emerging markets should continue to outperform. But this time it won't come from valuation.

Global growth projections: CAM forecast March 2021 vs. December 2020



Sources: Refinitiv-Datastream and CIBC Asset Management Inc.

Global bond strategies

In the first quarter, global bonds experienced a swift decline, as the benchmark global bond index[2] lost -3.09%. Stress was also palpable in emerging markets, with the benchmark[3] yield moving from 4.22% to 4.99%. The poor performance of global bonds across the board can be traced to one common factor—the swift re-pricing of the U.S. yield curve, as U.S. Treasury yields increased from 0.92% to 1.68%.

The Federal Reserve's adoption of its new average inflation targeting helped push market participants' inflation expectations higher in the first quarter. Combined with accelerating vaccination prospects that are leading to expectations of a global economic reopening, bond yields rose from their pandemic depressed levels early in the year. Those levels reflect more normal economic activity over the coming months and also lifted the real interest rate level component of nominal bond yields.

Putting our outlook on real yields and breakeven yields together (see side bar), Treasury yields should trade around 1.75% over the investment horizon. 10-year bond yields should operate inside a 1.25% to 2.25% range in the U.S. and between 1.00% and 2.15% in Canada.

Turning to sovereign bond allocations, our bond strategy remains similar to last quarter despite the recent volatility. We remain overweight emerging market (EM) bonds and underweight developed market (DM) bonds. The latest EM local yield increases constitute opportunities to add to existing EM bond positions. As the volatility in the U.S. Treasury market subsides in the next few quarters, EM local bonds should resume their outperformance. Factors also supporting our favourable view towards EM debt are the steepness of EM yield curves, high EM real yields by historical standards, our upbeat forecast on commodities and China, mild inflationary pressure in most EM countries, an improved EM structural landscape over the last 5 years and our bearish USD secular view.

Breaking it down

Real yields vs breakeven yields (i.e. the inflation expectation component of nominal yield)

Broken down by its components, 10-year real yields went from -1.06% to -0.68% while breakeven yields started the quarter at 1.97% and finished at 2.36%. Going forward, these dynamics should stabilize. Our base case scenario points towards breakeven yields slowly grinding higher and real yields remaining anchored well under 0%. The upside for breakeven should be limited from this point as the incoming rise in U.S. inflation is, in large part, already priced in to the bond market. Already at 2.30%, breakeven rates are likely to peak around 2.60% and fade back towards 2.30% afterwards.

The outlook for real yields appears less straightforward, however. Although strong growth momentum traditionally pushes real yield higher, the Fed is likely to keep influencing this market through continued active purchases to facilitate massive expected debt financing. As a result, real rates should remain anchored close to -0.50% over the horizon, and a slide to even lower levels cannot be ruled out.

Currencies

U.S. Dollar

The U.S. dollar staged a comeback during the first quarter of 2021, appreciating by more than 2% on a trade-weighted basis. The appreciation of the greenback since the start of the year was particularly strong against the Japanese yen, swiss franc and the euro. It's no coincidence that this happened just as the U.S. Treasury bond was experiencing a significant pullback owing to America's strong cyclical revival. Looking further out into 2021, however, the rest of the developed world will be accelerating vaccinations and easing lockdown conditions, leading to a broader global recovery.

This should allow the U.S. dollar downtrend to resume, given the forces at work. First, the greenback typically underperforms in global economic recovery phases like the one now taking place. Second, with the Fed's policy rate anchored near zero, the U.S. dollar no longer has an interest rate advantage. Last but not least, with the adoption of its new Average Inflation Targeting (AIT) policy framework, the Federal Reserve is implicitly targeting a weaker U.S. dollar and will continue to flood the world with U.S. dollar liquidity.

Canadian Dollar

Since hitting cyclical lows in late March, the Canadian dollar has been in rallying mode against the greenback, for a cumulative appreciation of approximately +17%. We think the Canadian dollar has more upside against the USD for three reasons.

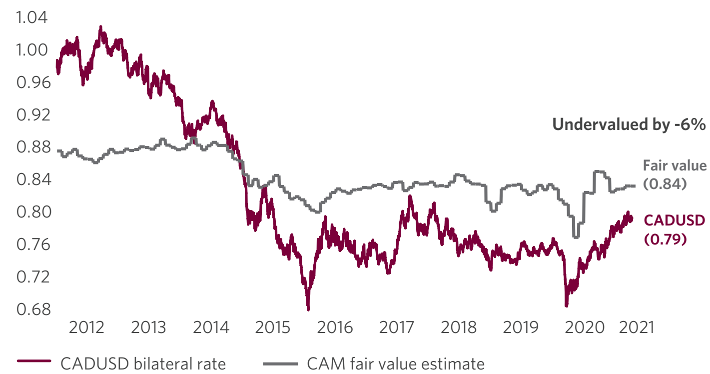
First, valuation is still not an obstacle for further appreciation of the Canadian dollar. When the Canadian dollar shifted to rallying mode in late March, so did its fair value via a fast improvement in terms of trade. The result has been almost no deterioration on the valuation front.

It's also worth noting that the positive terms-of-trade shock pushing the Canadian dollar higher is not just about stronger energy prices. Non-energy commodity prices are also up sharply from the cyclical lows reached in early 2020. Looking forward, there is room for an even bigger positive terms-of-trade shock via both higher energy and non-energy prices.

We also have to take into account that Canadian federal government bond yields have been moving higher in tandem with their U.S. equivalents. Canadian 10-year bond yields are now trading at +1.54%, roughly +100 bps higher than in 2020. As a result, Canadian bonds are now just as attractive as they were prior to the pandemic on an un-hedged basis.

For these reasons, the Canadian dollar is expected to stay in rallying mode. Looking forward, the Canadian dollar is expected to trade between .78 and .82 US cents (or 1.22 to 1.28 USDCAD) over the forecast horizon.

Canadian dollar still trading in undervalued territory
CAD/USD bilateral exchange rate & CAM fair value estimate



Sources: Refinitiv-Datastream and CIBC Asset Management Inc

Euro

For more than 13 years, the euro has been on a secular downtrend against the U.S. dollar. On four occasions, breakouts on the upside were attempted with no success. We witnessed a fifth breakout attempt over the second half of 2020, but the jury is still out on whether it will be successful. Indeed, EURUSD climbed all the way to 1.23 in early 2021 but gave back some ground since then. It has recently been retesting key support levels. In our opinion, once Europe's cyclical backdrop starts improving again, the euro will recoup some of the ground recently lost. Over the longer term, fluctuations in the EURUSD bilateral exchange will likely be increasingly dictated by supportive fundamental determinants. The EURUSD exchange rate is projected to trade between 1.16 and 1.23.

Japanese Yen

Since the start of 2021 and among the major currencies, the Japanese yen has been the currency that depreciated the most against the U.S. dollar. Why is that? For nearly five years, the Bank of Japan has been anchoring JGB 10-year yields around zero via its Yield Curve Control (YCC) policy. As a result, U.S. Treasury bond market pullback episodes have typically led to the strengthening of the USDJPY bilateral rate. The early 2021 episode was no exception. The +80 bps increase in U.S. 10-year Treasury yields observed since January has translated into a +7.4% appreciation of the U.S. dollar against the yen. With limited upside for Treasury yields from current levels, the USDJPY bilateral exchange rate is expected to fluctuate between 104 and 112 over the forecast horizon.

Commodities

Oil

Oil prices have been choppy year-to-date, rallying from a low of $47/bbl at the start of the year to a peak of $66/bbl in early March, before settling in the $60/bbl range towards the end of the month and into April. The push and pull on the price has been driven by concern around the third wave of COVID taking hold, offset by optimism around accelerating vaccination rates around the world.

Looking forward, the key to end-use demand for oil will be the pace of vaccination campaigns in certain countries and regions. The U.S. continues to race ahead with shots and re-openings, while Europe is on the verge of stepping up its own campaign, following several months of slower-than-anticipated rollouts. Crude oil consumption in China remains strong, which also goes a long way to support the market.

On the supply side, OPEC+ has been strategic in returning barrels to the market which, to this point, has helped support the commodity price. We are seeing global rig counts rise off a bottom, but note that the pace of growth thus far has been reasonable and off a low base. With oil prices at current levels, we expect producers will be tempted to start to bring more production back to the market and we'll watch production growth closely through the remainder of the year.

Overall, we believe the setup for oil prices into the second half of 2021 looks good. Rising global demand and some supply discipline should help keep the market fairly tight, which we believe will support the price.

Gold

The gold price has struggled year-to-date. After peaking at $1,950/oz in January, the price fell to <$1,700/oz in March, before bouncing back to $1,750/oz in mid-April. The fall in the price coincided with increasing interest rates, as the U.S. Government 10-year bond yield climbed from 0.9% at the start of the year to 1.7% by April.

Looking forward, we believe the outlook for gold remains constructive into the second half of the year. We believe both monetary and fiscal policies will remain accommodative as global economies begin to recover and reopen as vaccinations ramp up. Increasing money supply, lower interest rates and a willingness by central banks to tolerate higher-than-normal inflation could provide a tailwind for gold this year. On the other hand, if vaccination rates pick up more slowly than expected and the global economic recovery stalls, then there could be a flight to safety from investors. This could also provide a positive environment for the gold price in the coming months and quarters. 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 macroeconomic data, pandemic data and political/social developments

Copper

The copper price has been strong year-to-date, rallying from a low of $3.50/lb at the start of the year, to a nine-year high of $4.35/lb in late February, before settling around $4.00/lb in early April. The price has been driven by strong demand out of China and supply-side constraints from key producing countries in South America.

Looking ahead, continued strong demand from China will be an important driver of the copper price over the remainder of the year. In recent weeks, we've seen inventory levels of copper tick higher but off a low base. Should demand pick up in the coming months, the physical market for the red metal could tighten, leading to strength in the price. On the supply side, Chile is quickly ramping up its vaccination campaign, but at the same time the pandemic is accelerating, leading to a recently announced month-long border closure. Output from key South American countries will be important to watch in the coming months to see if supply can match demand this year.

We believe the setup for copper looks favourable into the second half of 2021. We see strong demand from China and potentially accelerating demand from the U.S. and Europe as economic conditions start to normalize. There is the potential for tightness in the copper market that could drive price appreciation through the year, as we expect supply will struggle to respond.

Regional economic views

Canada

- We expect average real GDP growth of 7.6% (y/y) over the forecast horizon, one of the strongest expansions since WWII.
- We'll be monitoring developments on the provincial debt sustainability front.

The Canadian economic recovery remained resilient at the beginning of the year despite renewed virus resurgence and containment measures. With the vaccine rollout likely to accelerate in the coming months, the Canadian economy should gain momentum from here. Our baseline scenario calls for average real GDP growth of 7.6% (y/y) over the forecast horizon, one of the strongest expansions since WWII.

Consumers are expected to remain Canada's growth engine this year. Forced consumption retrenchment and an increase in disposable income led to a significant increase in household savings in 2020. Some of this accumulated savings is likely to be spent as the re-opening of the economy proceeds. Consumer fundamentals are also likely to further improve this year. Worker compensation is set to continue to increase with the recovery of the labour market, while low interest rates should keep households' debt servicing costs low. Households are also benefiting from a substantial positive wealth effect thanks to strong financial asset performance and surging house prices.

In addition, fiscal and monetary authorities are expected to keep an accommodative policy stance over the forecast horizon. In its latest budget update, the federal government announced the extension of some of its key COVID-19 support mechanisms (i.e. Emergency Wage Subsidy and the Emergency Rent Subsidy) as well as new measures to stimulate the economy once the pandemic is under control. Meanwhile, the Bank of Canada (BoC) should keep the policy rate anchored near zero while continuing to monetize a large portion of the federal government issuance of debt securities.

A potential risk to our growth forecast for Canada stems from the important increase of the provincial governments' debt load. Like the federal government, all provinces significantly increased spending to counteract the impact of the pandemic. Their deficits widened significantly as a result, and their financing needs are nearly five times bigger than in previous years. However, provinces received little help from the Bank of Canada compared to the federal government, and the BoC recently announced that it will let the Provincial Bond Purchase Program expire in May. Funding conditions for provincial governments, which are already relatively tight, are at risk of worsening over the projection horizon.

Developments on the provincial debt sustainability front will therefore be something to keep an eye on, and we see two options to address the situation. The BoC either goes back on its decision and monetizes more of the provincial debt, or the federal government transfers more money to provinces, resulting in more issuance of federal debt securities and more BoC monetization.

United States

- Real GDP growth is projected to average +8.2% over the forecast horizon, the fastest growth in 79 years.
- U.S. consumer fundamentals have rarely been as strong as they are right now.

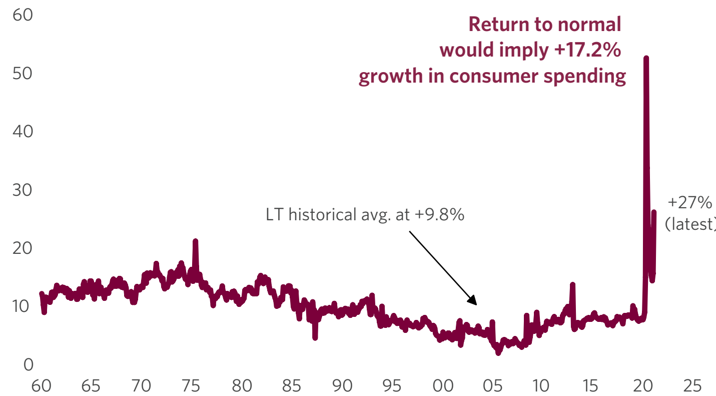
Bullish forecast still on track

Last quarter, we argued that the revival of the U.S. economy would likely surprise strongly on the upside in 2021. Our above-consensus view hasn't changed—our bullish baseline U.S. economic forecast remains on track, with real GDP growth projected to average +8.2% between 2021Q2 and 2022Q1, the fastest growth in 79 years.

This very upbeat projection is based on three key assumptions. First and foremost, U.S. consumers have massive firepower moving into 2021. Based on our calculations, the 2021 positive household income shock could very well be just as big as the one in 2020. This will include more helicopter money from the government and a sharp increase in worker compensation, on top of the excess savings already in hand. At the current juncture, personal savings still represent more than two times the normal consumer firepower. In short, U.S. consumer fundamentals have rarely been this strong.

Massive U.S. consumer firepower

U.S. personal savings as a % of total consumer spending



Sources: Refinitiv-Datastream and CIBC Asset Management Inc

Of course, our bullish U.S. forecast is also conditional on how the COVID-19 pandemic evolves. From this angle, there are also good reasons to feel more upbeat. In the United States, the share of the population that's received a first vaccination is fast-rising and the pace of new active cases is decelerating. On another good note, the number of U.S. COVID-19 related hospitalizations and fatalities has also been steadily declining.

The third key assumption relates to the need for close cooperation between the Federal Reserve and the U.S. Treasury Department to put the necessary conditions in place to stabilize the still fast-rising U.S. government's heavy debt load. Given that the 2021 fiscal impulse will likely be just as impressive as the one delivered by the U.S. Administration in 2020, it's clear that U.S. federal debt still isn't on a sustainable accumulation path. An essential condition to get it there is to generate much higher inflation over the long term. This is the main reason why the Fed unveiled its Average Inflation Targeting (AIT) policy framework a year ago. To reach its higher inflation objective, the Fed is expected to keep its policy rate anchored near zero while heavily monetizing government debt. Another necessary condition is for the Fed to keep new government borrowing costs well below the effective borrowing cost on the stock of existing Treasury debt by adjusting its purchases of debt securities when needed. This implies continued debt monetization and a fast expansion of its balance sheet.

Europe

- Our forecast calls for +7.7% average real GDP growth for the eurozone between 2021Q2 and 2022Q1.
- The Pandemic Emergency Purchasing Program (PEPP), initiated in March 2020, qualifies as a game changer for the eurozone.

Keeping the rose-coloured glasses on
In light of recent developments, it might be tempting to turn more bearish on the eurozone's outlook. However, after looking more closely at the forces at work, we're sticking with our previous call, even though the economic recovery has been significantly delayed owing to the pandemic. Looking forward, however, the eurozone could very well surprise on the strong side over the new forecast horizon. Our forecast calls for +7.7% average real GDP growth between 2021Q2 and 2022Q1.

The first reason why we're keeping our rose-tinted glasses on relates to the consumer firepower in the eurozone. Clearly, eurozone consumers did not get the same boost to income as U.S. consumers from government helicopter money. However, the renewed tightening in lockdown conditions has led to a more severe forced retrenchment in consumer spending. Combining this feature with modestly growing disposable incomes, consumers in the eurozone have ended up with record excess savings. Savings rates are still unusually high across the eurozone and this implies a potentially very strong rise in consumer spending once lockdown conditions start to ease.

The second reason why we're still betting on a stronger-than-generally-expected recovery in the eurozone relates to the efforts deployed by the ECB. As emphasized in previous editions of *Perspectives*, the new ECB policy regime is about much more than just negative policy rates. An important part of the new regime is the strong support provided to the banking system via the TLTRO III lending scheme. Another important aspect is the ECB's implicit yield curve control policy with heavy debt security purchases via its APP program. And there's more to the story.

In our opinion, it's the Pandemic Emergency Purchasing Program (PEPP) initiated in March 2020 that qualifies as the game changer for the eurozone. Why is that? For the simple reason that it finally introduces the missing element in the eurozone's monetary union: fiscal transfers. By buying much more of the new national, and to a lesser extent supranational, debt securities issued, the PEPP allows for eurozone governments to provide the required fiscal impulse in a more flexible manner. It's the concept of automatic stabilizers: the countries that need more help, get more help. Being fully monetized by the ECB, this additional fiscal stimulus comes with no additional debt servicing costs. In the complete ECB arsenal, the PEPP is by far its most powerful gun. The total PEPP envelope amounts to €1850 B and the ECB's PEPP debt security holdings increased by +€870 B in 2020. This means that the ECB still has a lot of buying to do (+€980 B) over the forecast horizon. It plans on conducting its PEPP purchases at a significantly higher pace in early 2021.

China

- Consensus opinion still underestimates the strong foreign demand tailwinds that will positively benefit China.
- Although the People's Bank of China (PBoC) will likely hold steady on interest rates, we expect it to reduce the reserve requirement ratio for banks.

Consensus opinion still underestimates the magnitude of the global recovery and the foreign demand tailwinds that will positively benefit China. Historically, periods of strong global growth (e.g. 2017-18 or 2010-11) have been associated with periods of positive economic surprises in China.

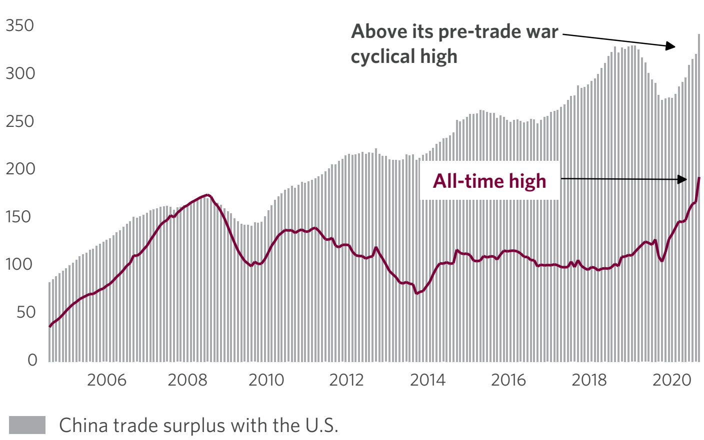
However, several factors that are expected to boost China's exports will be temporary. These include the upcoming global replenishment of low inventories, the fact that consumers in advanced economies have been spending more on goods as a result of a tight restriction on services, and the upcoming U.S. fiscal stimulus. The export growth impetus from those factors should reach a peak around Q3 and start to contribute negatively to GDP growth afterwards.

At the same time, the Chinese fiscal impulse will be turning negative. While the government recently announced it will again issue special-local government bonds to finance infrastructure projects, the amount announced is less than last year. Public infrastructure investment should start to decline in the second half of the year.

The transitory growth headwinds should result in a slowdown of economic growth in the second half of our forecast. However, thanks to a consumer that will likely play an increasing role as a growth engine, economic growth should remain marginally above potential.

Slowing growth and low inflation pressures, in a context of limited upward pressures on home prices inflation due to macroprudential[4] policies, should force the PBoC to hold steady on rates. However, we expect it to reduce the reserve requirement ratio for banks. This should ease the absorption of new special bond issuance over the medium term and better align monetary policy with the (costly) long-term national new infrastructure strategy. The strategy includes artificial Intelligence, electric vehicle (EV) charging stations, inter-city transportation, ultra-high voltage power transmission, 5G networks, and data centers.

China: Foreign demand tailwinds
China trade surplus (cumulated 12 months, USD B)



Sources: Refinitiv-Datastream and CIBC Asset Management Inc.

Alternative scenarios

Sluggish global recovery (15% probability)

In this scenario, the global distribution of the vaccine is too slow. 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 (25% probability)

The best-case scenario calls for herd immunity to be reached faster than in the baseline scenario. 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 (15%)	Global Equities High Yield Bonds Industrial metals	Gold U.S. Treasuries Swiss franc
Speedy return to normal (25%)	International bonds Canadian bonds U.S. Treasuries	Small cap equities Value equities Oil

Economic forecasts (next 12 months)

Region	Current GDP[5]	GDP - Consensus	GDP - CAM View	Current Inflation[6]	Inflation - Consensus	Inflation - CAM View	Policy Rate - CAM View
Canada	-3.2%[7]	7.3%	7.6%	1.1%	2.3%	2.3%	Near 0%
United States	-2.4%	7.3%	8.2%	1.7%	2.5%	2.9%	Near 0%
Eurozone	-4.9%	6.5%	7.7%	1.3%	1.7%	1.7%	Near 0%
China	6.5%	6.3%	7.1%	-0.2%	2.1%	1.8%	Cutting RRR[8]
Japan	-1.4%	4.2%	4.4%	-0.4%	0.2%	0.4%	Near 0%
World	-0.4%	6.7%	7.8%	2.0%	2.8%	2.7%	-

[5] Real GDP Growth (y/y %)
[6] Year/year %
[7] Implied (converted from a Q/Q basis)
[8] Reserve requirement ratio

Data as of March 2021
Source: Datastream, Bloomberg, CIBC Asset Management Calculations

[1] Helicopter money describes a monetary stimulus strategy that increases the quantity of the money supply by distributing cash directly to the public.
[2] FTSE WGBI hedged in Canadian dollars
[3] GBI-EM bond index
[4] The objective of macroprudential policy is to preserve financial stability by limiting the build-up of vulnerabilities in the banking and financial systems. Systemic risks can arise from excessive credit growth and leverage.