CIBC ASSET MANAGEMENT

PERSPECTIVES

For the 12-month period beginning January 1, 2022

50 YEARS

Table of contents

Taking away the punchbowl?

In retrospect, 2021 turned out to be another very good year for global investors. There was no stopping the bull market in risky assets, thanks in large part to still-prudent policymakers. Indeed, last year, while the global economy strongly recovered, the global liquidity tap stayed wide open.

Asset class highlights

Equity: Valuation is expensive, profit margins are at historically high levels and not expected to increase again in 2022. So sales will have to do all the lifting. However, sales rarely exhibit gangbuster growth, except right after recessions. As such, equity returns will likely be much lower than they have been in the last two years. Given the narrow landing strip and the risk of tipping overboard on either side, the path ahead for markets could be bumpy.

Fixed Income: With a more active Federal Reserve Board (Fed) in 2022, a scenario with a wider trading range for U.S. 10-year yields between 1.10% and 2.10% could prevail over the forecast horizon. On one hand, the prospects of reduced bond-purchase programs by major central banks might allow long-term yields to move higher in the early part of the year. However, a bit further on the horizon, the probabilities of a deeper global cyclical slowdown than generally expected have increased since our last forecast. Indeed, shifting monetary, credit and fiscal impulses could push the global cycle to decelerate, leading to lower Developed Market bond yields.

Currencies: Given the hawkish turn taken by the Fed late last year, the long-term U.S. dollar bull market that has been in place for more than a decade could very well resume.

China: We turned more bearish on China last quarter, reflecting expectations of falling housing activity and surging liquidity concerns for real estate developers. With a 4.4% GDP outlook, we remain below consensus and potential.

Multi-asset outlook

Asset class	Current December 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%	0.50%	1.00%
Canada 2-year government bond yield	0.95%	0.80%	1.50%
Canada 10-year government bond yield	1.42%	1.25%	2.05%
U.S. 10-year government bond yield	1.51%	1.10%	2.10%
Germany 10-year government bond yield	-0.18%	-0.45%	0.10%
Japan 10-year government bond yield	0.07%	-0.25%	0.25%
Canada 10-year real-return government bond yield	-0.14%	-0.15%	0.20%
Canada investment grade corporate spreads	1.15%	1.15%	1.30%
U.S. high yield corporate spreads	2.92%	2.70%	4.40%
Emerging market sovereign (USD denominated) bond spreads	330	250	500
S&P/TSX price index	21,223	19,500	23,000
S&P 500 price index	4,766	4,300	5,050
Euro Stoxx 50 price index	4,298	3,950	4,650
Japan Topix price index	1,992	1,825	2,150
MSCI Emerging Markets	70,053	65,000	78,000
U.S. Dollar/Canadian Dollar	1.2637	1.226	1.316
Euro/U.S. Dollar	1.1370	1.12	1.16
U.S. Dollar/Japanese Yen	115.08	110.00	118.00
U.S. Dollar/Offshore Chinese Yuan	6.36	6.30	6.70
Gold	1,829	1,600	2,000
Oil price, WTI (West Texas Intermediate)	75.21	50.00	85.00

Source: Thomson Reuters Datastream, CIBC Asset Management Inc.
All prices in home currency unless otherwise specified.

Asset class outlook

Global overview

Difficult navigation conditions ahead

In retrospect, 2021 turned out to be another very good year for global investors. There was no stopping the bull market in risky assets, thanks in large part to still prudent policymakers. Indeed, last year, while the global economy strongly recovered, the global liquidity tap stayed wide open.

Unfortunately, the story will likely be very different in 2022. All around the world, inflation is showing its ugly head. While developments on the pandemic front might still be a reason for concern, policymakers have no other choice but to take a hawkish turn. The first step is obviously for governments to clean up their fiscal houses by considerably reducing the size of their deficits, and for monetary authorities to reduce their purchases of government debt securities (i.e., tapering). The second step is trickier, as it consists of moving away from the near-zero rate policy. The challenge here is to deliver the right amount of policy rate hikes at the right speed so that the global economy ends-up experiencing a soft landing, not a hard one.

For many reasons, this balancing act should prove to be a very difficult one. At the top of the list of concerns, one finds China's economic woes. China's monetary authorities have recently shifted into easing mode, with the implicit objective of cushioning the economic downturn. Contrary to past easing cycles, however, there is no willingness to jumpstart the Chinese economy via a massive credit impulse. To put it differently, don't expect China to save the day by turning once again into the world's growth engine.

Needless to say, the apparently never-ending pandemic shock is complicating things further for central banks. While the impact of the Omicron wave on overall economic activity is expected to be modest and, more importantly, fleeting, Omicron is predominantly an inflation risk. Because of it, supply issues are likely to keep inflation higher for longer, with a risk to inflation expectations.

As if the task at hand for central banks wasn't difficult enough, their policy renormalization efforts will be taking place in the context of an intensifying global demographic shock. This matters because the aging of the world's population is impacting labour market conditions, productivity and, ultimately, inflation.

Last but not least, the risk of an overkill is greater than ever. True, it's not the first time that central banks have launched tightening campaigns; However, it is the first time that they do it with the debt burden of non-financial economic agents being three times bigger than the economy. The world economy is now more interest-sensitive than at any time in the past. It likely won't take much to go overboard.

All in all, the easy part of the global economic recovery appears to be over, with mounting pressure on central banks to deliver a faster and potentially messier policy renormalization. The faster they go, the higher the odds of a policy mistake. While there likely is no financial storm coming, more difficult navigation conditions likely are, implying greater uncertainty for the direction of financial markets and higher volatility.

Global strategy

A narrow landing strip for markets

The economy has passed its peak growth and is in the process of transitioning to the next phase in the cycle. The deceleration of growth and the normalization of monetary policy are now well under way. As the economy continues to slow down and monetary/fiscal policies are normalized, equity markets will face a number of headwinds. First, slower economic activity means slower earnings growth. Second, draining excess liquidity and raising policy rates should hurt valuation. Third, late-cycle inflation pressure should also hurt valuation, while also reinforcing the need for faster policy normalization.

A soft landing would be achieved if we get just the right amount of slowdown and policy normalization, and if inflation pressures fade. If this happens, bond yields would likely remain stable within a trading range. This is somewhat of a circular logic, as stable bond yields could be considered a necessary condition to get a soft landing. Despite the headwinds, equity markets would continue to do well, although with much lower returns than in the recent past.

Will the economy achieve a soft landing? This has become the consensus economic forecast. High equity valuation is also suggesting that markets assume as such. Our own forecasts are below consensus but also point toward a benign economic outlook(with downside risks). Basically, this is the economic soft landing hoped for. But it does not necessarily imply a smooth ride for markets. It is a fragile equilibrium that can easily tip over. In other words, the risk of a policy mistake is significant, whether the mistake is tightening too much or not enough. Furthermore, we don't need an actual mistake to shake markets—the perception of a potential mistake would be sufficient.

If policy tightening is too abrupt, the economy would face a hard landing and central banks would need to back off and ease financial conditions. Equity markets would correct and bond yields would come down. If, on the other hand, policy normalization is too timid, the economy would continue to overheat. Investors would start pricing that the central banks are behind the curve and bond yields would rise rapidly. The equity market would initially react favorably to the strong growth, but enventually it would struggle with the tightening in financial conditions.

Given the narrow landing strip and the risk of tipping over on either side, the path ahead for markets could be bumpy.

It might look like markets will be pricing back and forth between one scenario and another. To illustrate, at the end of November, the concern was about the risk the new Omicron variant represented for the economy. Equities retreated and bonds rallied. As evidence grew that Omicron was more contagious but less harmful than initially thought, equities recovered rapidly but it also removed a roadblock for the Fed, and bond yields moved up. At the end of the year, perhaps we'll look back and see that the global economy and markets turned out to do just fine. Along the way it might feel like we are constantly treading near the edge of the road.

At current bond yields and equity valuations, and given where we are in the cycle, neither bonds nor equities represent a strongly compelling tactical investment. To summarize our views: equities are expensive to buy at this point in the cycle, and yet we don't see the conditions to underweight them; bond yields are not attractive enough to buy at this point in the cycle, but it's getting late to underweight bonds. As such, the reasonable strategy for tactical asset allocation is to keep positions close to neutral and wait for better entry points.

We haven't talked about Covid so far. It's not that it doesn't matter anymore, it's that markets are learning to live with it. This is also increasingly the approach that many governments are taking in their efforts to control the pandemic. Covid remains a threat as shown with the Omicron variant. It is not the first variant and will most likely not be the last one. In terms of investment implications, Covid should be seen as a low probability tail risk.

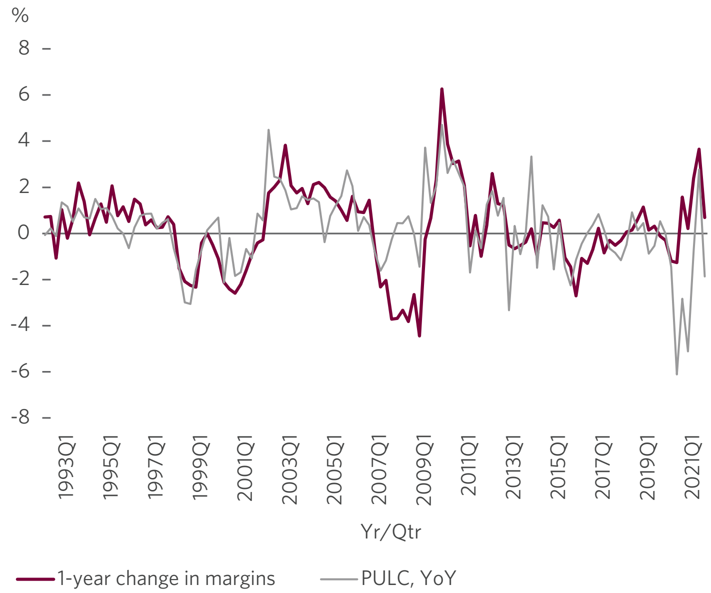
Global equity markets

A look back at 2021—and how 2022 could be different

2021 was a year in which global equities continued to roar ahead to new highs. The MSCI All Country Index grew by 19% in 2021 and at the end of the year stood 29% higher than its February 2020 pre-Covid peak. IT, energy and financials dominated, while the defensive sectors like telecom and utilities lagged. It is worth mentioning that most of the gains came in the first half of the year. The pace of the bull market slowed down in the second half.

After being driven by rising P/E ratios in 2020, equity returns in 2021 were driven by earnings. At the start of 2021, bottom-up analysts expected 26% global earnings growth for the upcoming year. It turned out that analysts greatly underestimated the rebound and earnings grew by 50%, providing a strong support for the equity market. That 50% growth came on the back of an 8% increase in sales, while the rest was driven by profit margins, which increased from 7.7% to 10.8% (a 40% expansion). The consensus expectation for 2022 earnings growth is 7%. Profit margins are at historically high levels and are not expected to increase again in 2022, so sales will have to do all the lifting. However, sales rarely exhibit gangbuster growth, except right after recessions. As such, equity returns will likely be much lower than they have been in the last 2 years.

U.S. profit margins



Sources: Refinitiv-Datastream and CIBC Asset Management Inc.
PULC: Price over Unit Labour Cost is a proxy measure for profit margins

China and Asia equities diverged greatly from the rest of the market and actually had negative performance. The Chinese economic cycle slowed down as the credit impulse turned negative. The unexpected development that amplified the slowdown was the tightening of regulations for the technology and real estate sectors. There are now signs that the effects of policy tightening have reached their pain threshold. As a result, it is expected that the Chinese leadership will act to ease and support the economy, albeit at the margin. In other words, just as the Fed is starting to remove policy accommodation, China will start to ease. Just as the U.S. economy is peaking, the Chinese economy will be bottoming. In relative terms, this should be an environment that will favour emerging markets over developed markets, more so because valuation also favors emerging markets.

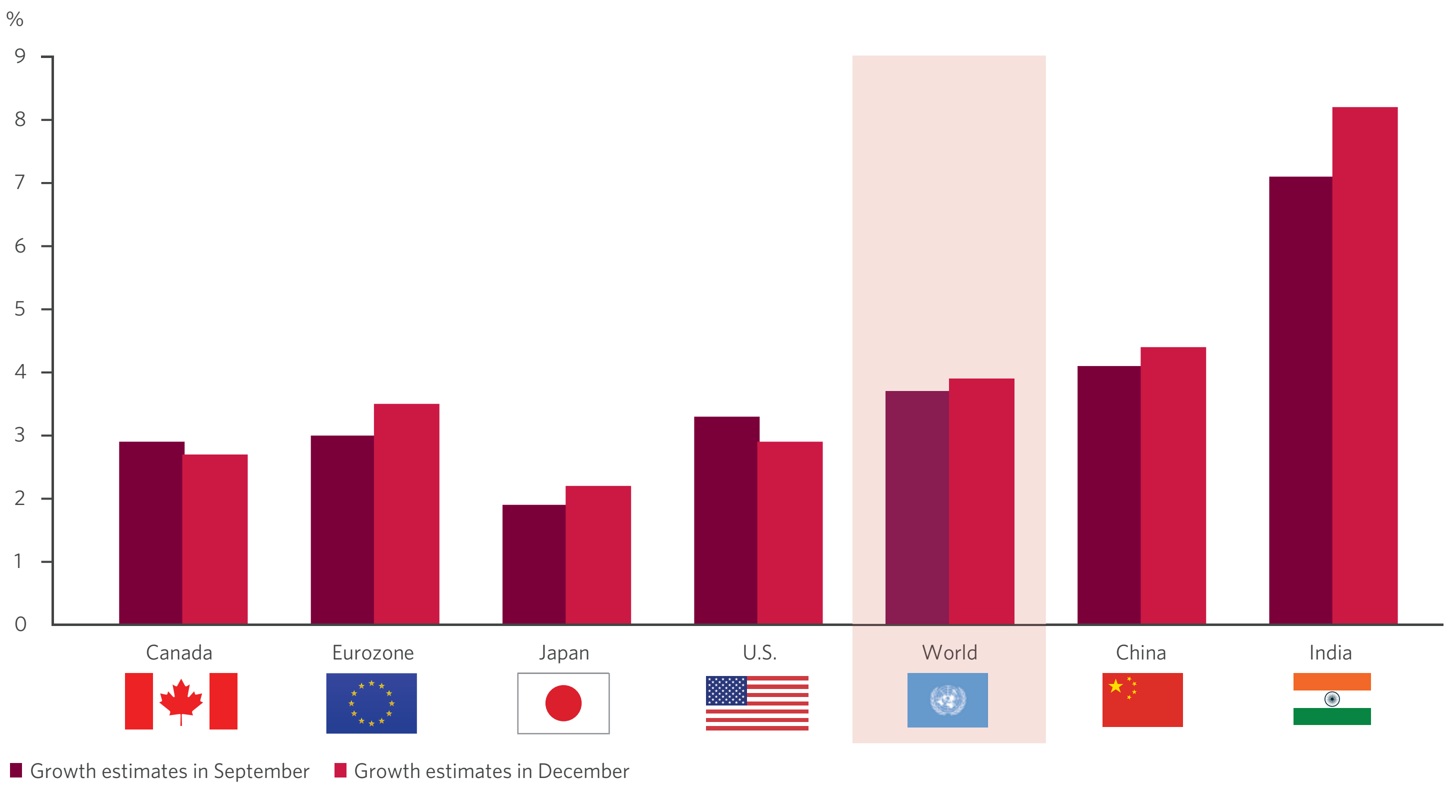
Global bond strategies

In the fourth quarter, Developed Markets (DM) bonds' performance was flat. U.S. 10-year yields finished the quarter three basis points higher than where they started, remaining tucked in a 1.26% to 1.66% corridor. With a more active Federal Reserve Board(Fed) in 2022, a scenario with a wider trading range for U.S. 10-year yields between 1.10% and 2.10% could prevail over the forecast horizon.

Crosscurrents should restrain bond yields from trending clearly in one direction or the other. Range-trading remains our favored strategy. On one hand, the prospects of reduced bond-purchase programs by major central banks might allow long-term yields to move higher in the early part of the year. However, a bit further on the horizon, the probabilities for a deeper global cyclical slowdown than generally expected have increased since our last forecast. Indeed, shifting monetary, credit and fiscal impulses could push the global cycle to decelerate, and this should lead to lower DM bond yields. Importantly, the path of energy prices, U.S. labour market dynamics and the speed by which the global supply bottlenecks resolve themselves will influence how long market inflation-expectations will remain stuck at elevated levels. Ultimately, this will dictate how strong the downside pressure on nominal yields will be, as we see the other component of nominal yields (i.e., real yields) continuing to hover close to current levels.

Outside the DM, we remain very selective and prudent with our emerging market (EM) bonds exposure. Several potential headwinds could complicate the macroeconomic environment for EM economies and EM central banks in 2022 and, in turn, lead to capital market outflows (like bonds). First, if the inflationary blowout (alternative scenario) were to happen in the U.S., demands towards EM economies could be negatively impacted. Secondly, if the Fed becomes more hawkish to address mounting inflationary pressure, the U.S. Dollar could outperform EM currencies, with negative implications for EM countries' trades, inflation and credit access. Thirdly, China was slow to ease financial conditions in 2021, and it's unclear how and when the People's Bank of China (PBOC) will significantly change its monetary and fiscal settings to buffer the economic softening. Moreover, the lagged impact of China's 2021 crackdown in key sectors, of the woes in the housing market, and of the credit impulse decline could further depress Chinese demand towards the rest of EM countries. Finally, many EM countries benefited from positive terms of trade in 2021, but this is unlikely to be repeated going forward. In sum, we will continue to tread carefully with our EM bonds exposure in 2022.

Global growth projections: CAM forecast December 2021 vs. September 2021



Source: Refinitiv-Datastream and CIBC Asset Management Inc.

Currencies

U.S. Dollar

2021 turned out to be a year of consolidation for the U.S. dollar (USD). The greenback stayed relatively weak over the first half of the year, but quickly recouped all the ground lost over the second half. Looking into the new year, the outlook for the USD remains complicated, as the drivers of the currency will tug in opposite directions. On the one hand, the Federal Reserve Board(Fed) is likely to be one of the more hawkish of the major central banks providing interest rate support against other low-yielding currencies in the early months of the year. On the other hand, however, uncertainty remains regarding how much U.S. real yields will rise and how fast. With elevated debt levels, we believe there is limited space for rising real yields, limiting USD strength. Last but not least, excessive valuation along with deteriorating fundamentals such as a large current account deficit and political uncertainty ahead of the mid-term elections could lead to renewed weakness. Given the offsetting forces at work, the USD is expected to stay in consolidation mode over the forecast horizon—that is, within a relatively wide trading range.

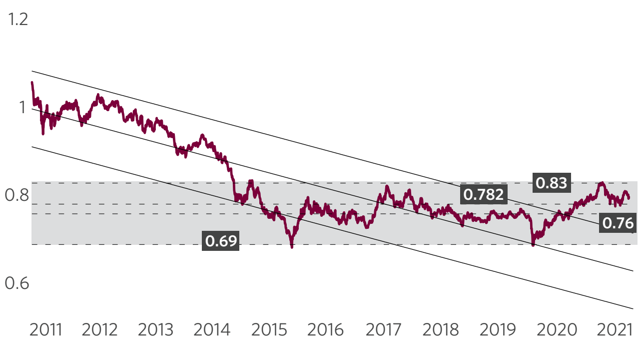
Canadian Dollar

The Canadian dollar(CAD) pretty much ended 2021 where it had started—that is, at around 79 U.S. cents. Will it remain in consolidation mode in 2022? We think it will. Looking forward, the CAD's fundamental determinants are expected to be less supportive in 2022 than they were in 2021. For one thing, we do not think there is a need for the Bank of Canada (BoC) to deliver rate hikes more aggressively than the Fed, as currently priced in. For another, we are not likely to see a replay of 2021, with fast-rising energy prices fueling the CAD's appreciation. Our forecast calls for a consolidation in energy prices, with oil ranging between $50 and $85 over the forecast horizon.

As with the USD, the CAD will take its direction from the strong but decelerating global economy, the speed of the BoC's policy renormalization and the commodity outlook. On net, we expect these forces to support the currency early in the year and fade thereafter. The CAD is expected to stay in a range most likely defined between 76 and 82 U.S. cents.

Canadian dollar: More consolidation in 2022?

CAD/USD bilateral exchange rate and key technicals



Sources: Refinitiv-Datastream and CIBC Asset Management Inc. as of September 2021.

Euro

Moving out of 2021 and into the new year, the dominant view has been, and remains, that the ECB policy renormalization will be a lot slower than that of the the Fed and most other central banks in the developed world. Needless to say, this had been acting as a big drag on the value of the euro (EUR) against the USD. In 2021, the EUR/USD bilateral exchange rate depreciated by more than 7%. Could the EUR lose even more ground in 2022? We think it will remain under pressure—that is, at least over the first half of the year. The second half of the year could, however, be a very different story, with rising odds of a faster-than-generally expected hawkish ECB policy pivot. For the year as a whole, the EUR is expected to stay in consolidation mode against the USD, trading between 1.12 and 1.16.

Japanese Yen

In currency-land, the big surprise of 2021 has to be the pronounced weakness of the Japanese yen(JPY). It's the G-10 currency that lost the most ground against the USD in 2021, depreciating by more than 10%. At first glance, such weakness may seem surprising. After all, this currency normally has strong fundamental support, given Japan's wide and widening current account surplus. We suspect that the Bank of Japan(BoJ) policy actions largely explain the JPY's unusual behavior. For nearly five years, the BoJ has been anchoring JGB 10-year yields around zero via its Yield Curve Control policy. As a result, U.S. Treasury bond market pullback episodes have typically led to the strengthening of the USD/JPY bilateral rate. Looking forward, we see limited upside for Treasury yields and, by ricochet, for the USD/JPY bilateral exchange rate. We are working with a targeted range of 110 to 118 between now and year-end.

Commodities

Oil

Despite a choppy end to 2021, oil prices regained their upward trajectory in late December and into January, breaking through $80/bbl as the market continues to largely look through the recent wave of the pandemic.

Demand has remained reasonable, despite growing Covid case-counts around the world. On the supply side, OPEC+ has remained disciplined in its return of barrels to the market, sticking to its schedule, with full compliance from member nations. At the same time, other sources of supply growth (i.e., U.S. shale) have not returned aggressively. Investors continue to signal to producers that balance sheets should be strengthened further and any additional capital should be allocated to buybacks and dividends rather than to production growth.

Looking forward, we will continue to watch for signals on demand growth in the coming months to gauge where support is for higher oil prices this year. On the supply side, we will continue to watch for data on the return of incremental barrels of oil to the market from OPEC+ and other producers around the world. Risks to the strong oil price-environment could come from slower-than-expected global GDP growth, faster-than-expected return of supply at higher commodity prices, further coordinated releases of strategic petroleum reserves, or other geopolitical factors impacting either supply or demand.

Gold

Gold has consistently bounced between $1,750/oz and $1,850/oz over the past six months as the market continues to weigh mixed signals from key indicators like inflation, interest rates and economic growth. High headline inflation numbers signal a positive backdrop for gold, but upside has been muted by tapering and rate-hike signals from the Fed. With that mixed backdrop in mind, investors have largely stepped back from gold, leaving it to drift in the previously mentioned trading range.

Looking forward, inflation remains a focus for investors. The debate around the transitory nature of inflation (or not) and the timing of the rate-hike cycle have remained key data points on the outlook for gold. Given the recent headline inflation numbers reported and the expected timing of rate hikes, we believe gold remains supported in the near term. Clearly, the risks to the gold price are faster-than-expected rate hikes and a moderation in inflation numbers and expectations.

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

- 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 remained rangebound, trading between $4.20/lb and $4.50/lb over the past six months. While the upward trajectory may have stalled, we note that the current price environment is very healthy and well above the global cost-curve for production of the commodity. Producers are generating significant free cash flow at current prices and the global copper market remains fundamentally tight.

Looking forward, we remain constructive on the near- and medium-term outlook for the copper price. On the demand side, China, the key market for copper, has signaled a policy loosening cycle, which should be supportive for commodity demand. On the supply side, Chile and Peru have struggled to maintain production levels and attract new investment as Covid and political uncertainty have impacted output and growth from these key copper-producing countries. At the same time, global copper inventory levels are low, which could keep physical markets tight, and is another supportive data point for the near-term copper price outlook.

Finally, looking a bit further out, over the medium- to longer-term, we continue to believe the narrative around a structural bull market in copper remains in place. Copper will be a critical metal in the transition to a lower-carbon economy, and significant new volumes of the metal will need to be incentivized into the market to meet this new area of demand. To bring these new tonnes into the market, a higher copper price will be needed.

Regional economic views

Canada

- The Canadian economy is expected to slow from around 4.8% in 2021 to 2.7% in 2022.
- Inflation should also decelerate from 4.7% y/y currently to a bit above 2.0% y/y at the end of 2022.

The Canadian economy grew strongly in 2021. Significant progress has been made on several economic fronts. One notable development has been the recovery of the labour market. Indeed, all the jobs lost in the pandemic have been recovered over the past year, and the unemployment gap is currently estimated to be closed. The state of the labour market is increasingly resembling the one seen in 2019, suggesting that wage pressures should continue to build up in the coming year.

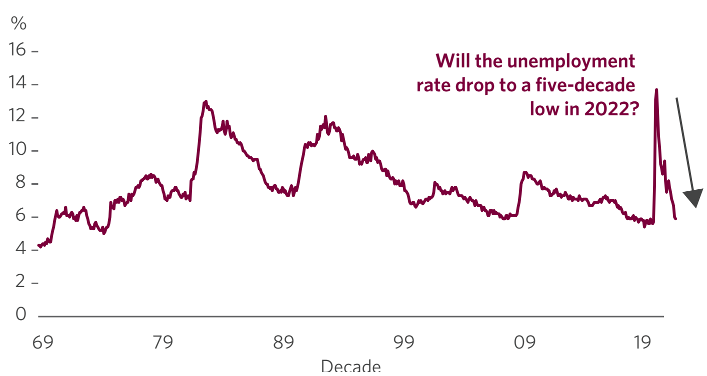
Another important economic development has been the surge in inflation. Canadian headline inflation was at 4.7% y/y in November 2021, its highest level in 30 years, while the three core inflation measures of the Bank of Canada (BoC) were also at record highs. The high level of inflation, which is now believed to be more persistent than previously expected, puts the central bank in an uncomfortable position. As a result, the BoC ended its Quantitative Easing Program and shifted its forward guidance at the end of last year.

All of this roughly coincided with the renewal of the BoC monetary policy mandate. Last December, the central bank announced that it will keep inflation as its main mandate objective, but it also introduced requirements to consider the labour market in order to support maximum sustainable employment. As a result, the BoC now has a dual inflation and employment mandate. Considering the level of inflation and the fact that the slack in the Canadian labour market is eroding quickly, we are now expecting the BoC to increase its policy rate by 75 basis points in 2022.

Canadian households remain heavily indebted and sensitive to interest rate increases. Consumption should therefore moderate, and so should the housing market. We expect real GDP growth to slow from around 4.8% in 2021 to 2.7% in 2022. Inflation is expected to decelerate over the coming year, finishing the year slightly above the BoC's 2% target.

A Canadian unemployment rate below 5%?

Canadian employment rate (%)



Source: Refinitiv-Datastream and CIBC Asset Management Inc

United States

Messier fed policy renormalization

With headline CPI inflation running at more than 6% in late 2021, inflation has been overshooting the Fed's comfort zone by a long shot. In light of these developments, the Fed had no other choice but to embark on a faster monetary policy renormalization path. To be more precise, this means tapering faster than initially planned to allow for an earlier first rate hike delivery. Just how much faster the Fed will be renormalizing will, to a large extent, depend on the build-up in cost-push inflationary pressures as measured by unit labour costs.

If our forecast materializes, labour market conditions will continue to tighten over the forecast horizon. Tight labour market conditions typically come with higher wage inflation. This is not necessarily bad news—that is, as long as productivity growth also stays elevated to keep unit labour costs in check.

Unfortunately, this is easier said than done. Over the last decade, U.S. productivity growth has averaged only +1.4% on a year-over-year basis. We did get an impressive productivity resurgence in 2020 and early 2021 as businesses all around the world learned to cope with the pandemic shock by adopting new processes and technologies. Unfortunately, the post-pandemic positive productivity shock has proved to be transitory. Productivity growth has sharply decelerated, turning negative in the second half of the year.

More importantly, the post-pandemic positive productivity shock pales in comparison with the structural negative demographic shock that is hitting most countries in the developed world. America is no exception, with the 55 & over age cohort accounting for a very large and fast-rising chunk of the working age population (37%). As the dependency ratio continues trending higher over the coming years, productivity growth is more likely to disappoint than to surprise on the upside. To put it differently, pressure will be mounting on the inflation-fighting Fed to deliver a faster and potentially messier policy renormalization. The faster the Fed goes, the higher the odds of a Fed policy mistake.

Europe

A Hawkish ECB Policy Pivot in 2022?

Moving out of 2021 and into the new-year, the consensus view has been, and remains, that the ECB's policy renormalization will be a lot slower than that of the Fed and other central bankers in the developed world. In 2022, the biggest surprise would thus be for a hawkish ECB policy pivot. What are the odds?

To answer this question, the first thing to look at is what's happening on the inflation front in the eurozone. While inflation moved well above target in late 2021, the relevant question to determine what's next for the ECB is whether inflation will stay above target over the coming years. After all, what the ECB adopted in the summer of 2021 is a symmetrical 2% inflation target over the medium-term.

Upon closer examination, one finds that developments on the inflation front are not as preoccupying in the eurozone as they are in the United States. This is because the surge in inflation observed in late 2021 has been almost entirely driven by energy prices. From this angle, the most likely outcome is for an energy-led deceleration in the eurozone's headline inflation rate over the forecast horizon.

What about cost-push inflationary pressures? The ECB assumes that they won't be a problem in 2022. While it is projecting high wage inflation (+3.8%), this is expected to be largely offset by high productivity growth (+2.9%), keeping unit labour cost inflation in check (+0.9%). In other words, the ECB is quite upbeat about the eurozone's productivity growth prospects. To put this in perspective: prior to the pandemic shock, productivity growth averaged a meager +0.4% in the eurozone.

If all goes according to plan, the ECB will only slowly renormalize its policy stance. This would imply: (1) no policy rate hike over the forecast horizon; (2) ending the Pandemic Emergency Purchase Programme in March as planned; (3) cushioning the hit by temporarily increasing its purchases of debt securities; and (4) offering the last tranche of the TLTRO III lending scheme to banks in June 2022. However, this is only if everything goes according to plan. In our opinion, the build-up in cost-push inflationary pressures could very well be more intense than projected by the ECB because of lackluster productivity growth. If we are right, the ECB will have to take a hawkish turn earlier than generally expected.

China

- With a 4.4% GDP outlook, we remain below consensus and potential.
- To stabilize growth, we expect a policy pivot targeting renewable-energy investment.

Bank Liquidity Squeeze Intensifies

We turned more bearish on China last quarter, reflecting expectations of falling housing activity and surging liquidity concerns for real estate developers. In recent months, new housing supply has contracted, demand weakened, and downward pressures on prices emerged.

While stringent macroprudential rules reining in real estate will most likely be loosened, they should remain restrictive due to other policy objectives. These include re-allocating investment in high-tech and green-energy industries, limiting the build-up of housing oversupply, and preventing further deterioration of affordability.

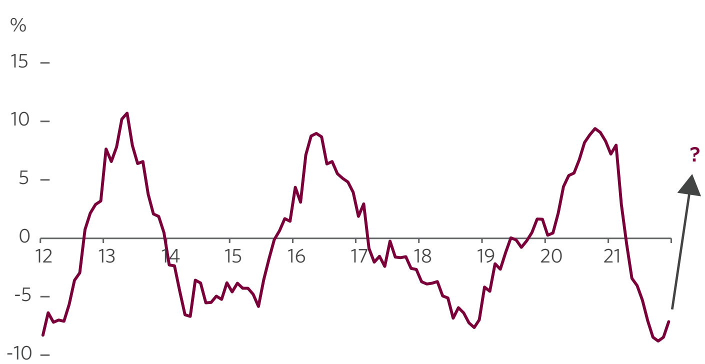
The consumer should remain another cause of growth disappointment. Income and consumption have remained lackluster, despite buoyant foreign demand and limited virus outbreaks. The arrival of the highly contagious Omicron variant in China should bring more frequent and less successful lockdowns.

While a policy pivot is needed to bring growth closer to potential, implementing one will be challenging operationally. The aforementioned housing objectives, along with sizeable upward cost-push pressures and an increasingly hawkish Fed, are not compatible with a big-enough reduction of policy rates. For fiscal policy, the shortage of new and profitable infrastructure projects, along with the stratospheric amount of special local government bonds issued last year, limit the magnitude of the positive fiscal impulse authorities can deliver.

Instead, front-loading decarbonization investment (solar panels, wind energy, and smart grids) is the path we expect policymakers to take. China still relies on coal to produce nearly 60% of its energy, despite having become the global leader of renewable energy. We expect an acceleration of green-energy investment equivalent to about 0.5-1.0% of GDP in 2022, which would lift growth in the second half.

Cheap funding from PBOC's green loan facility and increased issuance of bonds by local government financing vehicles (LGFVs) and state-owned enterprises (SOEs) would provide financing. In a context of elevated defaults from real estate promoters, and to help banks absorb a sizeable share of the stratospheric amount of bonds to be issued by local government entities in 2022, we expect the PBoC to cut further its reserve requirement ratio.

Growth stabilization or cyclical rebound?
Chinese credit impulse (second derivative)



Sources: Refinitiv-Datastream and CIBC Asset Management Inc.

Alternative scenarios

No more pent-up demand (25% probability)

After a strong government-induced spending binge, the consumer runs out of fuel. Disposable income takes a big hit as government transfers shrink. The excess savings that the consumer was forced to accumulate during the lockdown are insufficient to make up for the fiscal drag. The consumer has already front-loaded purchases of durable goods and inflation has eroded its purchasing power. Although not a recession in this scenario, growth slows down significantly and comes well short of expectations. Corporate earnings will disappoint and equity markets will generate negative returns. Bond yields will decline toward the bottom of their trading range as central banks need to reaffirm a commitment to policy support.

Persistent inflation (25% probability)

The supply bottlenecks created by the pandemic prove to be hard to fix. The tightness in inventories and in the global supply chain mean a disruption in one place can create supply shortages all along the chain. Limited supply is met by solid demand as the global economy benefits from ongoing reopening. Inflation persists in housing, commodities, goods and spreads to labour cost. Initially, this scenario is positive for cyclical assets like equities and commodities, as they benefit from the robust growth. But eventually markets face the fact that central banks are falling behind the curve and the expected tightening triggers a correction. Nominal bond yields move up sharply as both the real yield and the inflation breakeven move up.

Scenario	Less favourable	More favourable
No more pent-up demand (25%)	Global Equities High Yield Bonds Commodities	Gold U.S. Treasuries Swiss franc
Persistent inflation (25%)	Eurozone Bonds U.S. Treasuries EM Bonds	EM Equities Commodities Breakeven Inflation

Economic forecasts (next 12 months)

Region	Current GDP[1]	GDP - Consensus	GDP - CAM View	Current Inflation[2]	Inflation - Consensus	Inflation - CAM View	Policy Rate - CAM View
Canada	4.0%[3]	4.0%	2.7%	4.7%	3.5%	2.8%	Near 0%
United States	4.9%	4.0%	2.9%	6.8%	4.5%	3.2%	Near 0%
Eurozone	3.9%	4.1%	3.5%	5.0%	2.5%	2.3%	Near 0%
China	4.9%	5.1%	4.4%	2.3%	2.2%	2.9%	More RRR[4] cuts
Japan	1.2%	3.1%	2.2%	0.6%	0.8%	0.9%	-
World	4.8%	4.5%	3.9%	4.9%	4.4%	4.3%	-

1 Real GDP Growth (y/y %)
2 Year/year %
3 Implied (converted from a Q/Q basis)
4 Reserve requirement ratio

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

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