Q2 | 2021

# Global Macro Outlook

## A period of divergence


Frances Donald
Global Chief Economist and Global Head of Macroeconomic Strategy

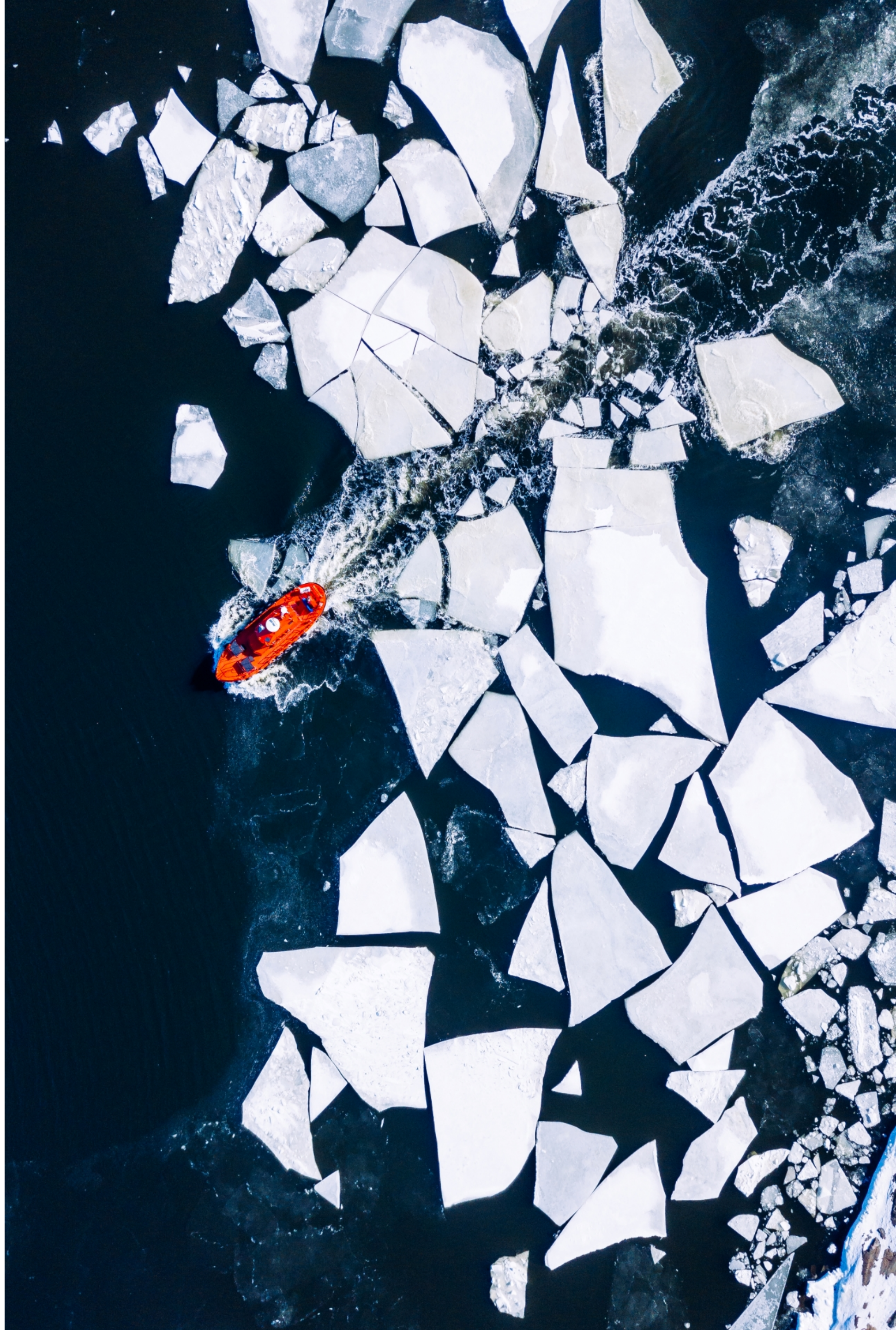
Alex Grassino
Senior Global Macro Strategist

Sue Trinh
Senior Global Macro Strategist

Eric Theoret
Global Macro Strategist

Erica Camilleri
Investment Analyst


Manulife Investment Management



# Global

# Global economic outlook: a period of divergence

## Introduction

As we take another pulse check of the global macroeconomic environment, we find ourselves focusing on how tremendously uneven the recovery continues to be. This is certainly true for sectors—services continue to lag manufacturing significantly—and also for regions, with economic activity in the United States set to soar on the back of pent-up demand while growth momentum in China slows.

We're also beginning to see greater divergences in monetary policy—with the Fed scaling back emergency programs as investors prepare for an eventual tapering of its asset purchases, while the European Central Bank and other central banks ramp up their respective bond programs to contain rising rates.

The biggest known unknown in our outlook is the extent to which the unprecedented level of fiscal stimulus that was unleashed globally in last 12 months will affect growth and inflation. While vaccine rollouts and how COVID-19 might evolve remain a key risk to the highly anticipated **great reopening** of the global economy, we no longer see the pandemic as the most important macro driver going forward.

From an investment perspective, we believe that the most attractive opportunities will be regional and sectoral in nature, particularly as we prepare for ongoing bouts of fixed-income volatility as the market adjusts to the new normal and, more than likely, a brief period of countertrend U.S. dollar strength.

**Frances Donald**
**Global Chief Economist and**
**Global Head of Macroeconomic Strategy**



Source: Macrobond, Manulife Investment Management, as of March 3, 2021.

# Global economic outlook: key themes for Q2

| Inflation | Central bank communication | Services sector ramps up | Emerging markets | Domestic challenges |
|---|---|---|---|---|
| We expect headline inflation in the United States to rise significantly in Q2 to highs rarely seen in the past decade. Where the financial markets are concerned, what matters is whether inflationary pressure will persist into Q3 and Q4. We don't expect it to, but it's worth noting that any evidence of *sustained* inflationary pressures above 2.5% on a year-over-year basis is the largest—and most important—risk to our outlook and the markets. | Central bank communication can represent a risk in the coming quarter as policymakers begin to look for ways to normalize monetary policy without exacerbating a sell-off in the bond market. Reaching a happy medium isn't likely to be a smooth process—expect bouts of volatility in fixed-income markets as the yield curve continues to steepen gradually and interest rates climb higher. | We expect the global services sector to catch up fairly aggressively with global manufacturing activity in Q2. That said, it's worth questioning if the global industrial complex (including commodities) can maintain the current level of strong performance throughout the entire quarter—it's one of the few downside risks to our outlook. | We remain long-term, strategic believers of emerging-market (EM) assets—both equities and debt. However, peak liquidity, the expected appreciation of the USD (however brief), and the slowing growth momentum in China suggest that EM assets could experience mounting headwinds in the coming months. We view any periods of underperformance as an opportunity to re-engage. | While investor focus will no doubt be on the great reopening of the global economy, the growth outlook for many economies continues to be defined by domestic structural challenges—from persistently low inflation (Japan) to systemically low levels of fiscal support (Europe), to potential housing bubbles (Canada). These themes may seem less relevant in the immediacy of the recovery but remain important pillars of our macro views. |



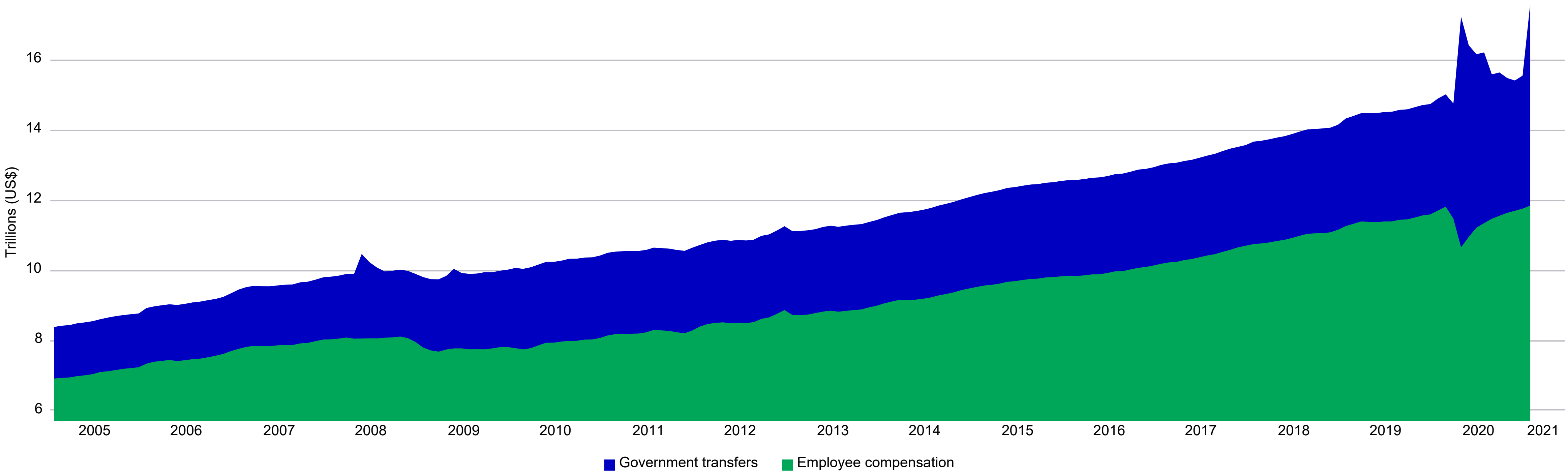
Source: Macrobond, Manulife Investment Management, as of March 3, 2021. This information contains forecasts reflecting potential future events and is only as current as of the date indicated. There is no assurance that such events will occur.

# United States

# United States: economic outperformance is likely to continue

The United States has outperformed most developed economies since the start of the year and should continue to do so throughout 2021. Key drivers include sizable fiscal stimulus, likely additional infrastructure spending, and an accelerated vaccination rollout. The ramp-up in the pace of the inoculation program has helped to normalize mobility levels and should continue to do so. It should also lead to a surge in services spending, along with a jump in services sector employment. As we get closer to business as usual, we expect the U.S. Federal Reserve (Fed) to prepare the markets for the eventual unwinding of quantitative easing, which we believe will begin before the end of 2021.

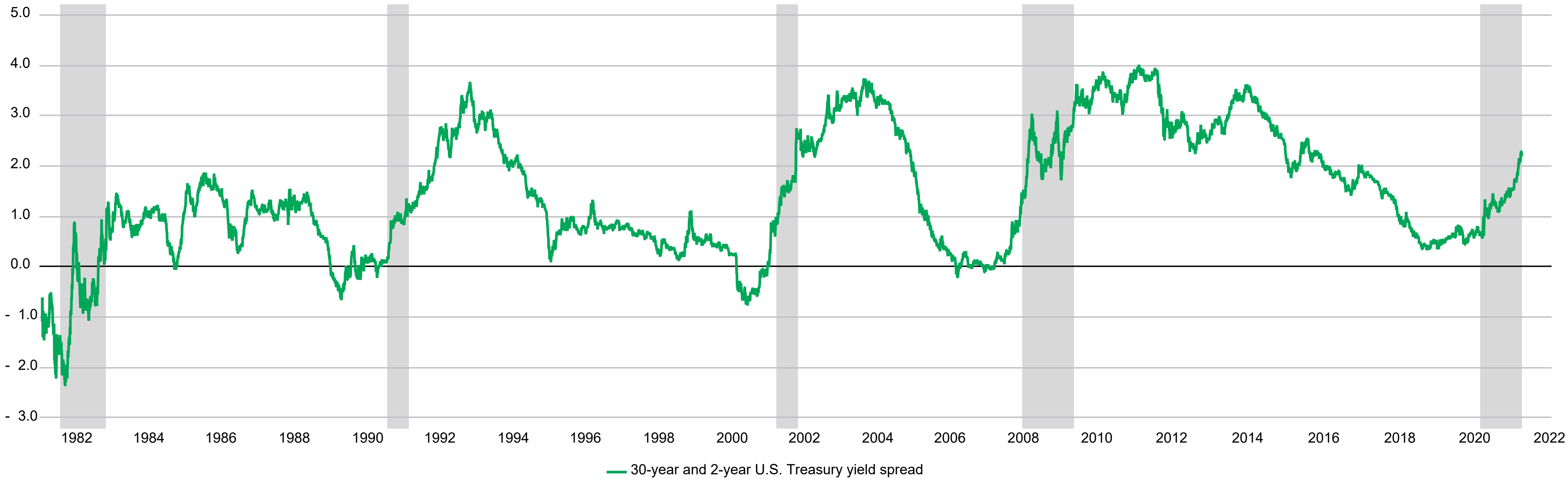
**Fiscal stimulus has pushed income levels higher again**



# United States: key market views

- **Equities:** Given that the S&P 500 Index appears to be fully valued, we expect modest index-level returns to take a backseat to stock selection and sector rotation to take place as the next phase of the pandemic plays out.
- **Interest rates/yields:** While we expect a modest decline in rates following an aggressive rise in Q1, we ultimately believe the 10-year interest rate could rise to 2.0% by year end; crucially, the path higher is likely to be volatile and driven by Fed communications. We expect the yield curve to steepen aggressively as the 30-year yield continues to climb while the Fed attempts to keep the 2-year well contained.

**Spread between the 2-year and the 30-year yield—room to run further**



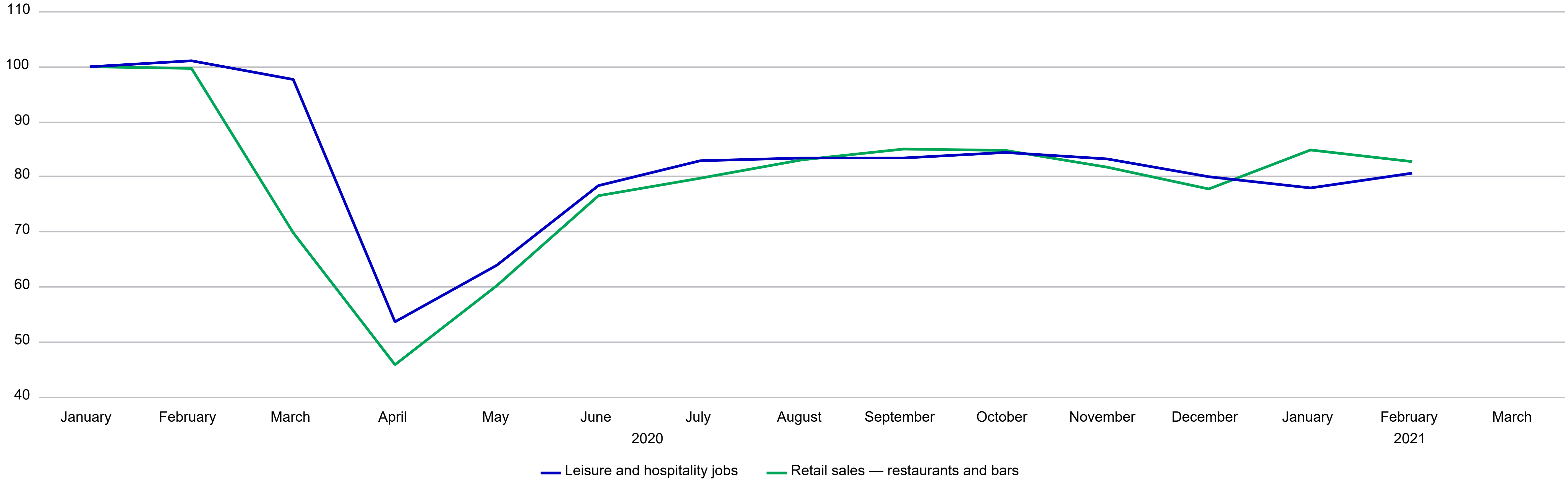



Source: Macrobond, Manulife Investment Management, as of March 18, 2021. Gray areas represent recessions.

# United States: risk to our views

- **Fiscal stimulus:** The current package has been fully priced in, but uncertainty remains around the size and composition of a proposed infrastructure deal.
- **Weaker hiring in the services sector** would create uncertainty around a very consensus forecast. This could lead to volatility beginning in the fall.
- **Materially higher interest rates** could begin to weigh on equity market returns.

**Unsurprisingly, jobs in hospitality have followed the uptick in economic activity**





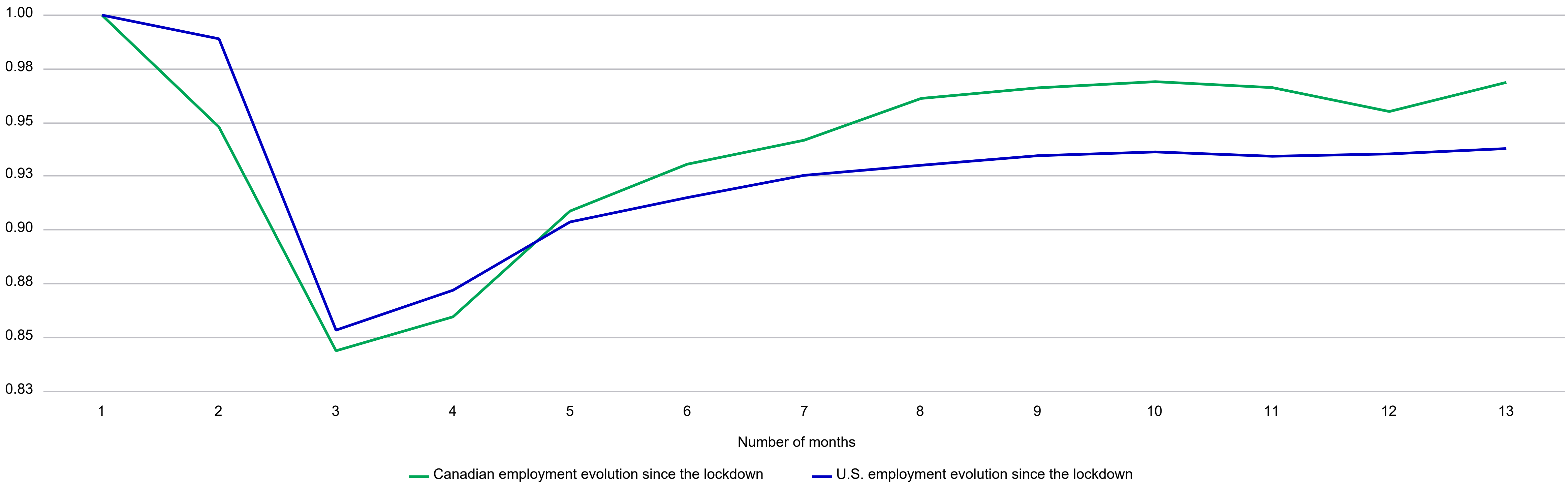

Source: U.S. Census Bureau, U.S. Bureau of Labor Statistics, Macrobond, Manulife Investment Management, as of March 22, 2021. Both indicators are indexed to 100 using January 1, 2020, as a base.

# Canada

# Canada: recovery is slightly delayed, but fiscal policy provides ample support

We believe the Canadian economy is on track to follow the developed world with a robust second half, led by a sizable pop in services activity; however, a slower vaccination schedule means that Canadian recovery is likely to be slightly delayed. Interestingly, the Bank of Canada (BoC) has tied its monetary policy response to the pace of vaccinations rollouts, thereby suggesting a slower pace of monetary policy normalization is likely. That said, Canada's fiscal response is stronger relative to its developed peers, which we believe will continue throughout 2021. This should provide ample support to the economy, particularly the Canadian jobs market.

**Fiscal stimulus played a meaningful role in supporting Canada's jobs market relative to the United States**



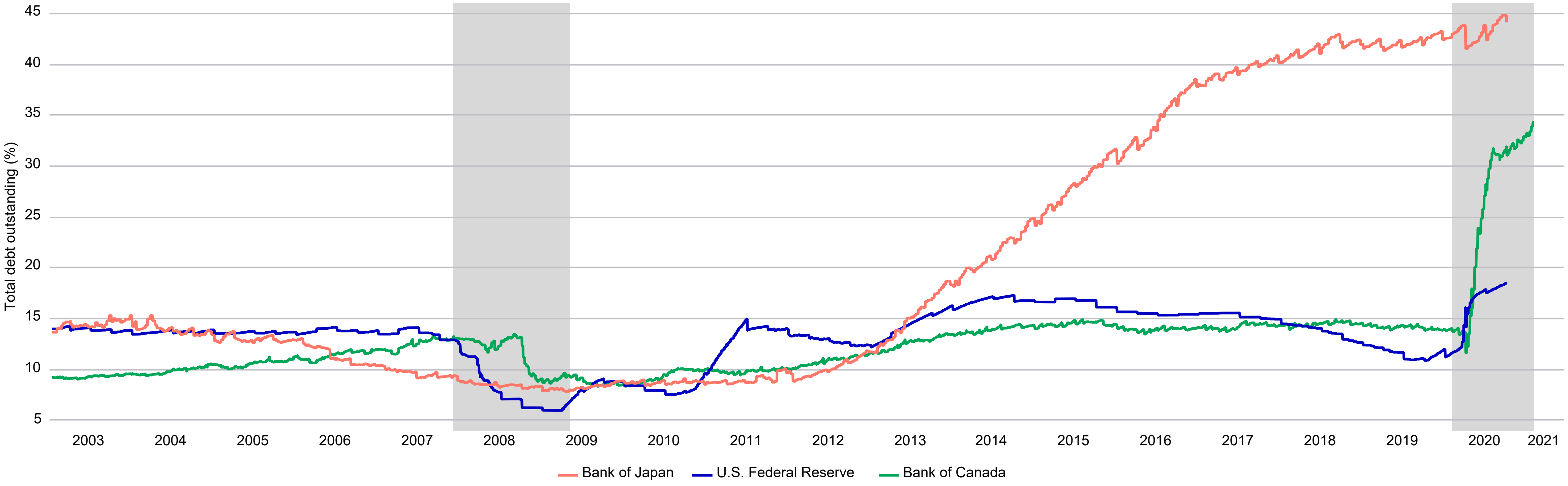



Source: Macrobond, Manulife Investment Management, as of March 3, 2021. Both indicators shown in the chart are indexed to 1.00, using January 1, 2020 as a base.

# Canada's economic outlook: what to monitor

- **Housing sector:** Housing activity remained robust throughout the pandemic—with low interest rates providing meaningful support to sales activities. We're seeing evidence of speculative activity and believe there's heightened probability of some form of regulatory response.
- **Bond-buying program:** The BoC's holding of Canadian government debt, as a share of the market, is particularly high relative to the United States. The bank may need to make adjustments to its bond-buying program to avoid distortions in the market. That said, any policy action could be paired with a commensurate form of easing to avoid any unwarranted tightening of financial conditions.

**Central bank holdings of total government debt outstanding**

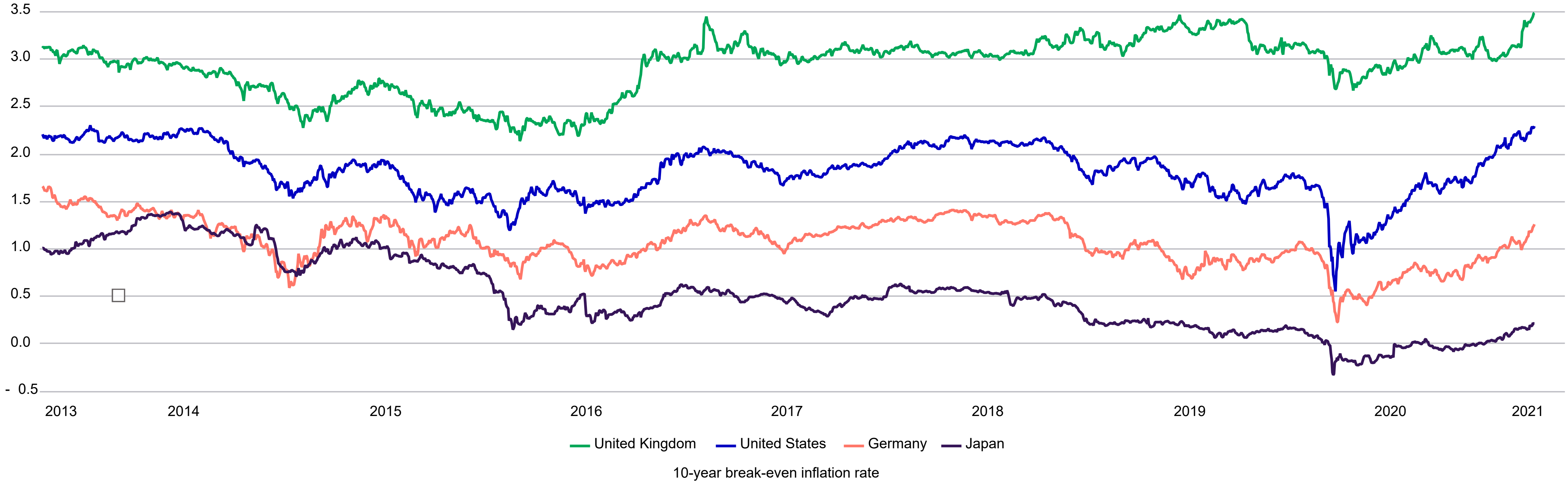


# Europe

# United Kingdom: successful vaccination rollout provides economic uplift

The United Kingdom's relative success in vaccine rollout puts it head and shoulders above most other major developed economies and offers a tailwind for growth in 2021. At this juncture, the United Kingdom is poised to capture even greater upside—at least on a relative basis—as its services sector benefits from the expected relaxation of social distancing measures. The recent U.K. budget also surprised to the upside, offering a fiscal tailwind to assist in the economy's reopening over the next couple of quarters. Inflation expectations in the United Kingdom aren't only well anchored, but also relatively elevated, having traded solidly above 2.0% over the past five years or so.

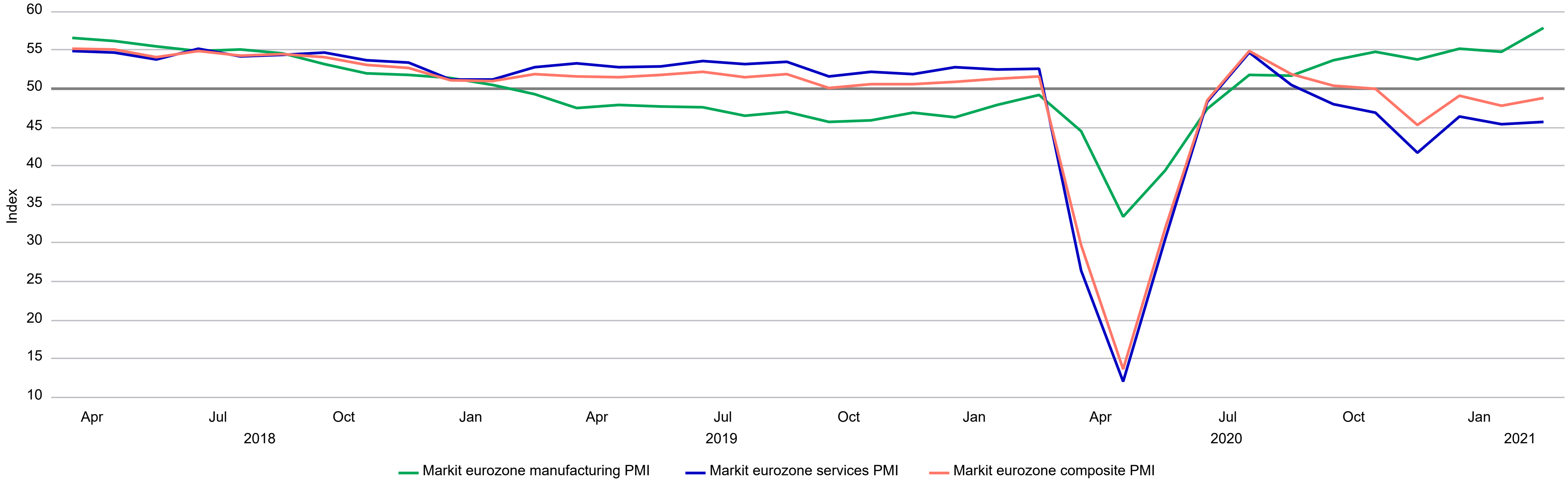
**Inflation expectations in the United Kingdom remain well anchored (%)**



# Euro area: pace of vaccine rollout weighs on outlook

The euro area's near-term growth outlook remains relatively underwhelming. A renewed rise in COVID-19 case counts has led to the re-imposition of social distancing measures in key European economies even as vaccine concerns place a brake on rollout efforts. The European Commission's guidelines on fiscal rules are dovish at the margin and imply that its temporary suspension on deficit limits could be extended through mid-2022. That said, European fiscal stimulus programs, while sizable, pale in comparison with those in the United States and the United Kingdom. Upcoming general elections in Germany and France (September 2021 and April/May 2022, respectively) are also areas of concern.

**Manufacturing activity in the euro area continues to drive the region's economic recovery**





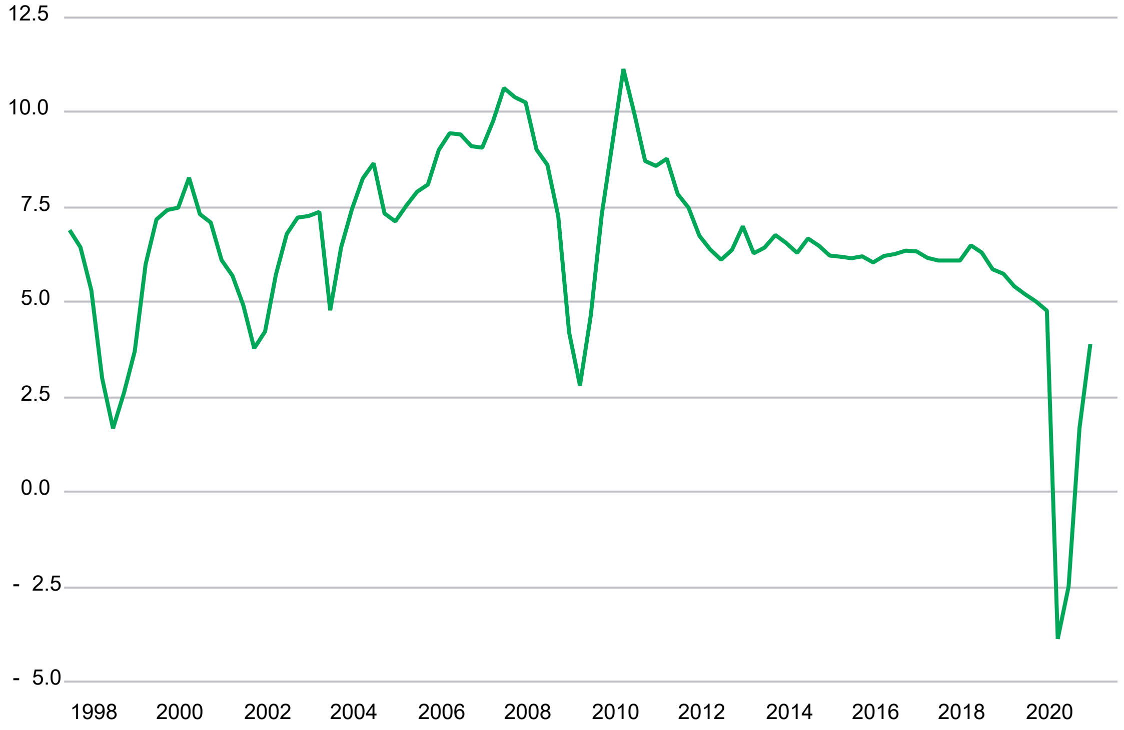

Source: Macrobond, Manulife Investment Management, as of March 3, 2021. PMI refers to Purchasing Managers' Index.

# Asia

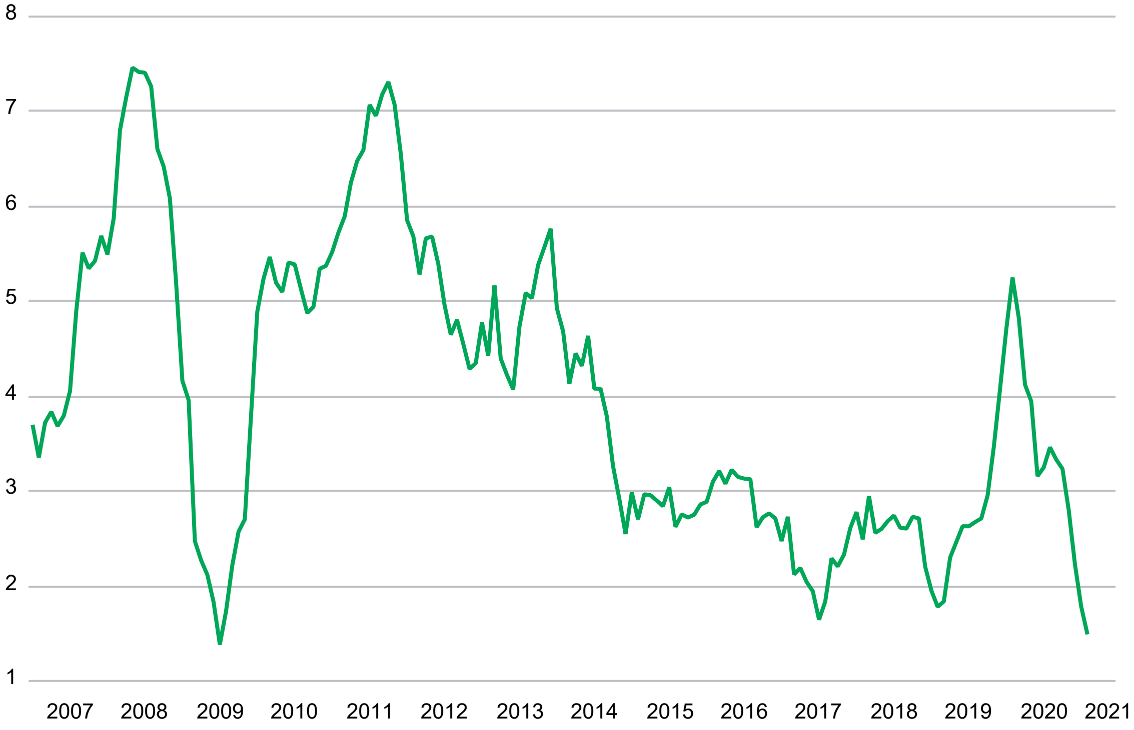
# Asia: strength of economic recovery differs across the continent

There are significant variations in the strength of recoveries across Asia: Philippines ended 2020 more than 12.0% below its pre-crisis GDP trend, Thailand and Malaysia were 8% to 9% below trend, while Taiwan and China fared relatively better, at 0.2% higher and 0.5% below their respective pre-crisis GDP trend. The composition of growth has been uneven: Manufacturing, particularly electronic exports, continues to power regional growth, while consumer demand lags sharply. We expect most Asian economies to remain well below their pre-crisis GDP trend even as disinflationary pressures persist. Central banks in Asia are likely to maintain easing biases for an extended period of time.

**Asia ex-Japan GDP, YoY (%)[1]**




**Asia CPI inflation, YoY (%)[1]**



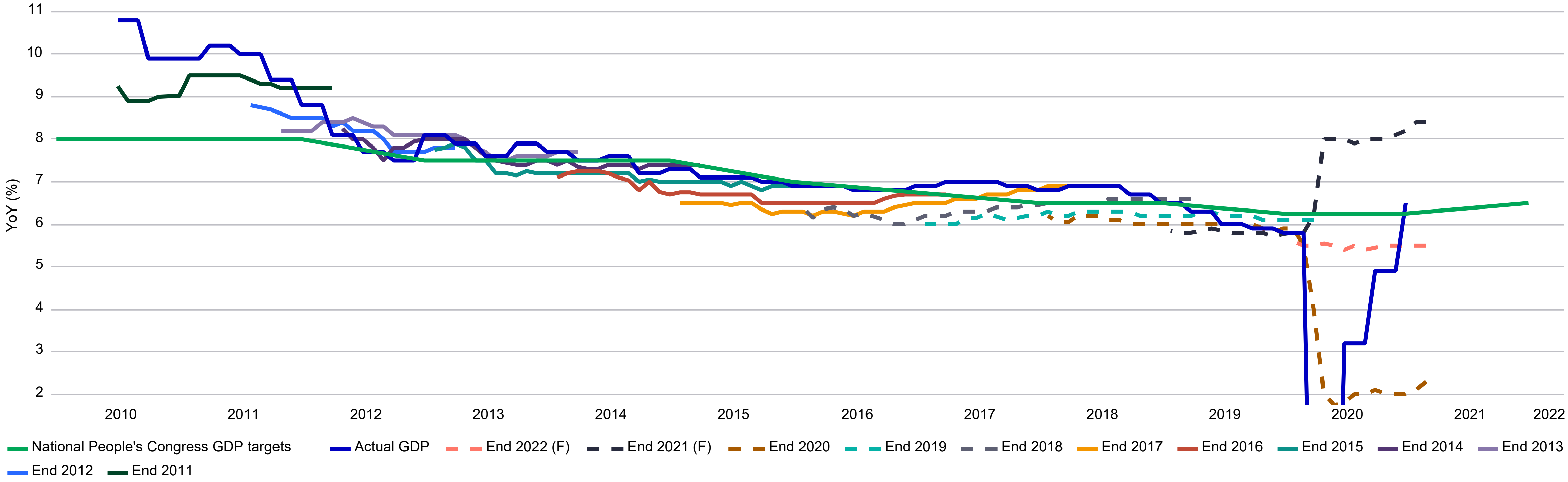



1 Macrobond, Manulife Investment Management, as of March 15, 2021. YoY refers to year over year.

# China's growth targets: less ambitious than expected

Details from China's National People's Congress support our view that the Chinese economy has hit a cyclical peak. The 2021 GDP target at over 6.0% is well below consensus estimates of around 8.4%[1] and should be easily achieved through base effects without the need for additional stimulus. Indeed, China's political leaders have set out to tighten the fiscal deficit from 3.6% to 3.2%[1] with no mention of a lower overall interest rate, a sign that monetary support could be less accommodative going forward. Credit will also be tightened aggressively, by ~20.0% from the previous year, signaled by a pledge to keep growth in money supply and aggregate financing to the real economy in line with nominal GDP growth.[2]

**China: GDP consensus[3]**

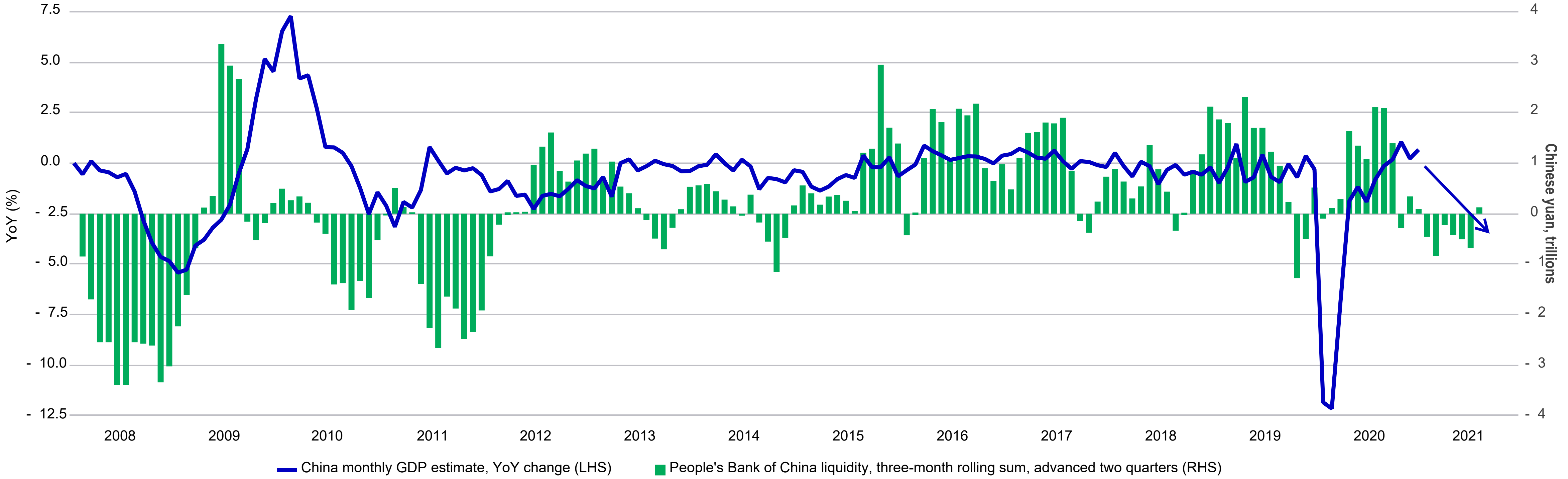



1 "Full Text: Report on the Work of the Government," xinhuanet.com, March 12, 2021. 2 "China's Central Bank to Step Up Efforts to Curb Financial Risks," Bloomberg, March 9, 2021. 3 Macrobond, Manulife Investment Management, as of March 15, 2021. YoY refers to year over year. Apart from GDP targets and actual GDP, the remaining indicators represent market consensus estimates.

# China's economic outlook: factors to watch

- **Credit growth:** The Chinese government is targeting a much weaker credit impulse this year relative to 2020. The expected slowdown in credit growth will weigh on the wider economy in the second half of the year.
- **The Biden administration:** Review of critical supply chains, which is aimed at insulating the United States from shortages of critical imported components—such as semiconductor chips, large-capacity electric vehicle batteries, rare earth, and pharma—is due to take place by early June. Tighter U.S. import controls will likely affect Chinese exports, the key pillar of China's economic growth last year.

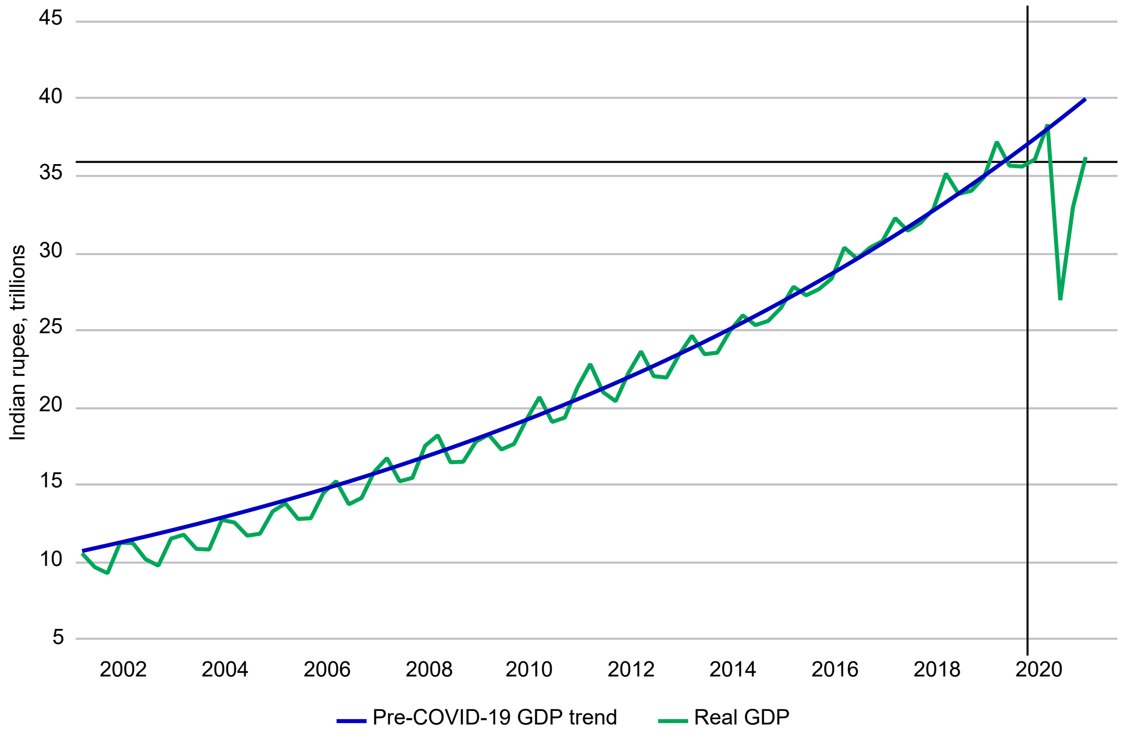
**Tighter liquidity conditions imply downside risks for Chinese GDP growth**



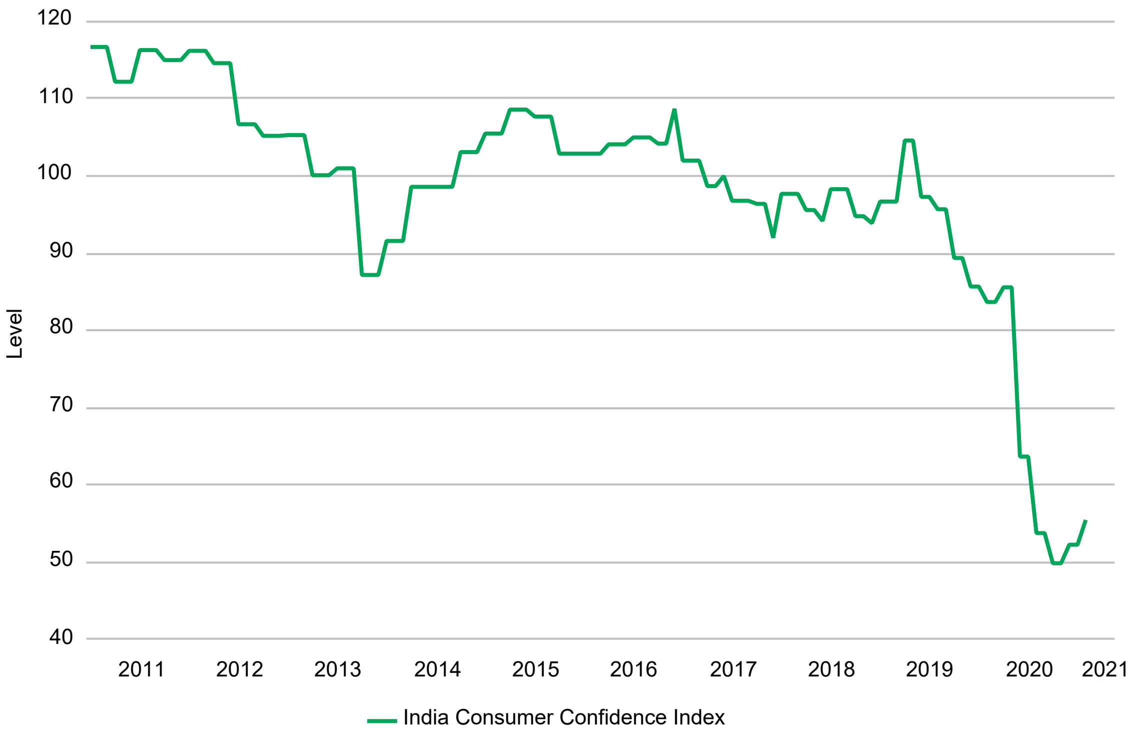
# India: an ambitious budget that addresses key issues

We're encouraged by India's 2021 union budget: It's a solid five-year plan for deficit-fueled growth with a spending focus that supports crucial sectors such as public health, domestic infrastructure and industry, and finance. Notably, the government signaled its commitment to resolve the country's nonperforming loans problem by injecting 200 billion rupees into public sector banks and announced the creation of a bad bank to manage these assets.[1] Crucially, India's Q4 2020 GDP beat expectations, bringing the economy back to pre-crisis levels three quarters sooner than anticipated. That said, the ultimate goal remains getting back to the pre-COVID-19 trend, which is still some ways off.

**India real GDP growth[2]**




**Consumer confidence is key to economic recovery[2]**

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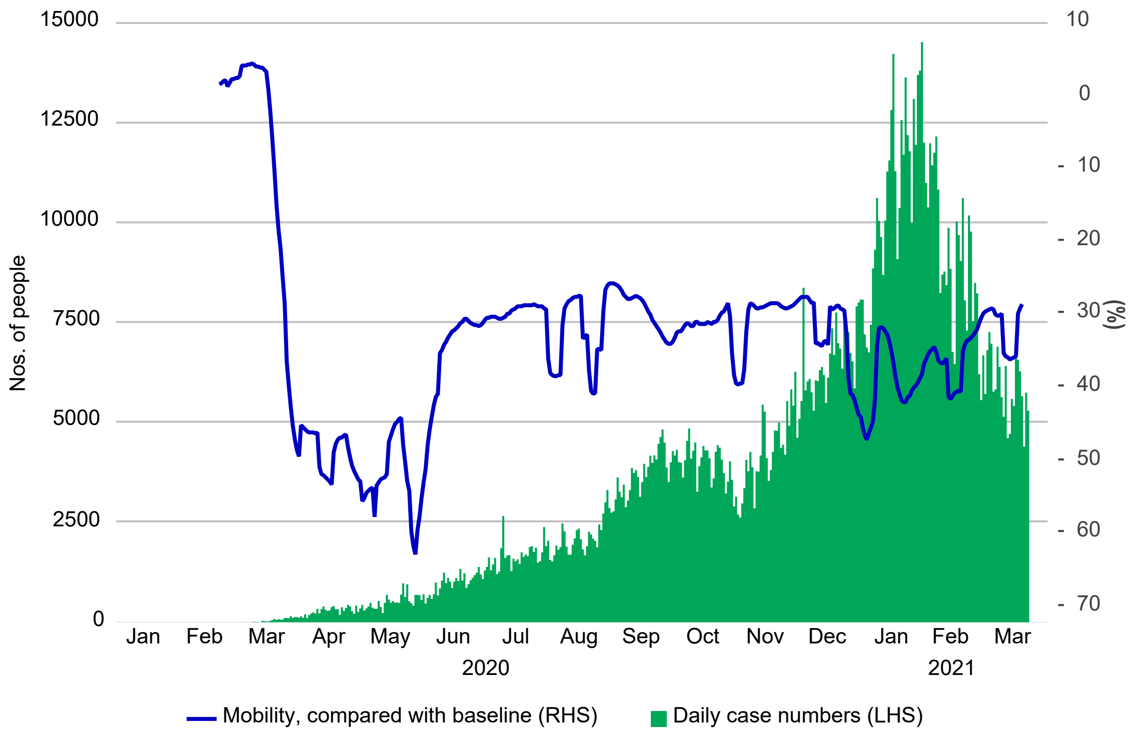
**1** "India to Set Up Bad Bank For Record Levels of Soured Debt," Bloomberg, February 1, 2021. **2** Macrobond, Manulife Investment Management, as of March 15, 2021.

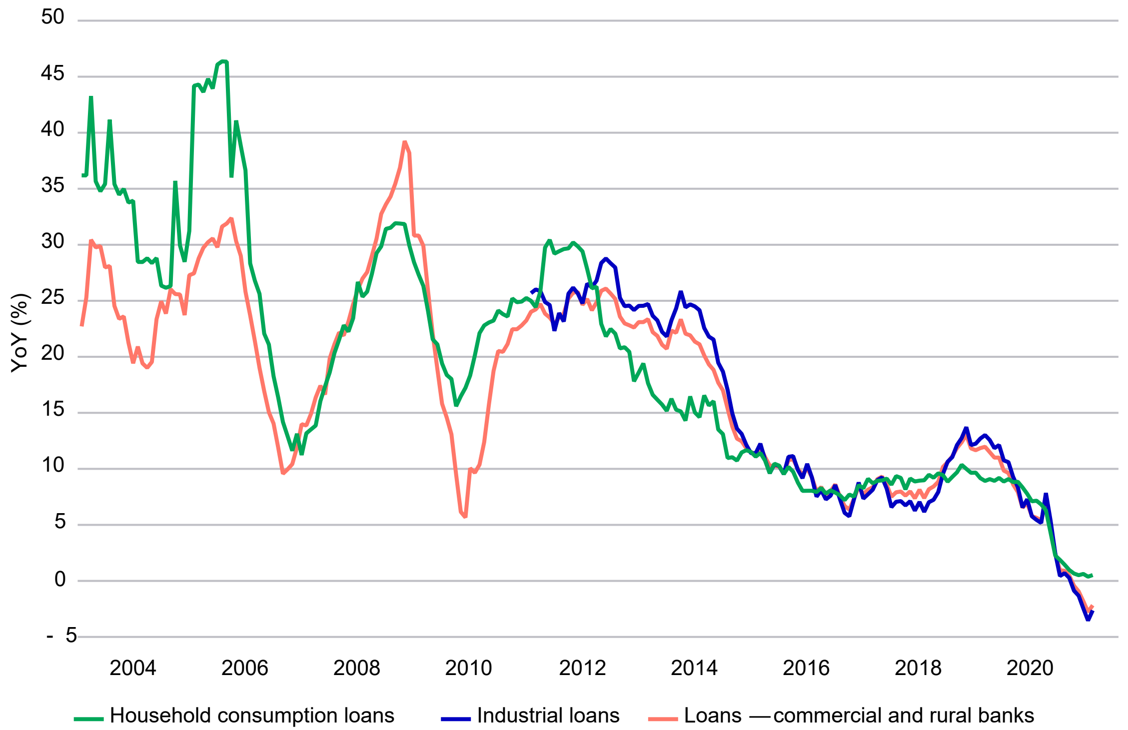
# Indonesia: a sluggish recovery

GDP growth in Indonesia contracted by 2.1% in 2021,[1] its worst performance since the Asian financial crisis. While the trend in the daily COVID-19 case count is improving, mobility levels remain depressed and vaccine rollout has been slow. Bank Indonesia (BI) cut its policy rate again in February to 3.5% and revised down its GDP growth forecast for 2021 from between 4.8% and 5.8% to between 4.3% and 5.3%.[1] Notably, the central bank shifted its stance by stating that room for further interest-rate cuts was limited[1] (it had previously emphasized available space for easing). We expect credit growth to remain subdued and that further policy support, including rate cuts, will be needed.

**Indonesia: improvement in daily COVID-19 cases, but mobility's depressed[2]**




**Credit growth in Indonesia remains subdued[2]**

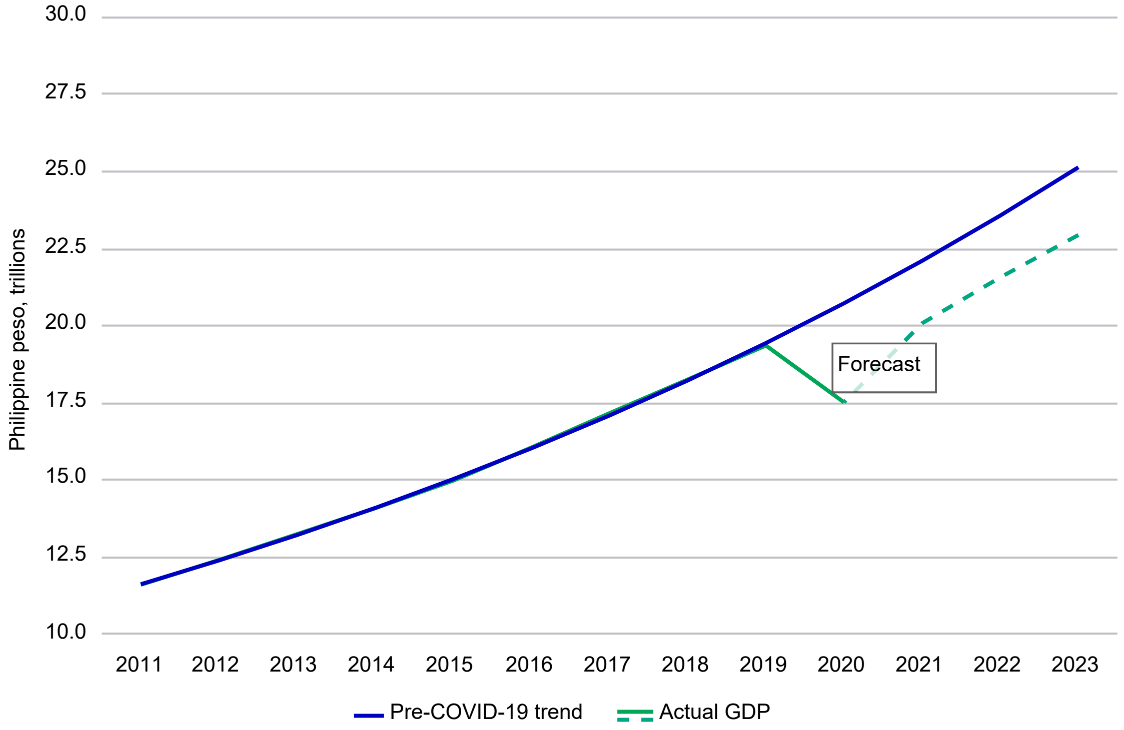



**1** Bank Indonesia, March 12, 2021. **2** Manulife Investment Management, as of March 15, 2021. LHS refers to left-hand side; RHS refers to right-hand side. YoY refers to year over year. The baseline is the median value for the corresponding day of the week during the five-week period between January 3, 2021, and February 6, 2021. Mobility is represented by a diffusion index, calculated by the following formula: Mobility around the workplace (% deviation from baseline) minus mobility around residential (% deviation from baseline), and take a seven-day moving average. A more/less negative number indicates more/less people are staying at home instead of going to their workplaces.

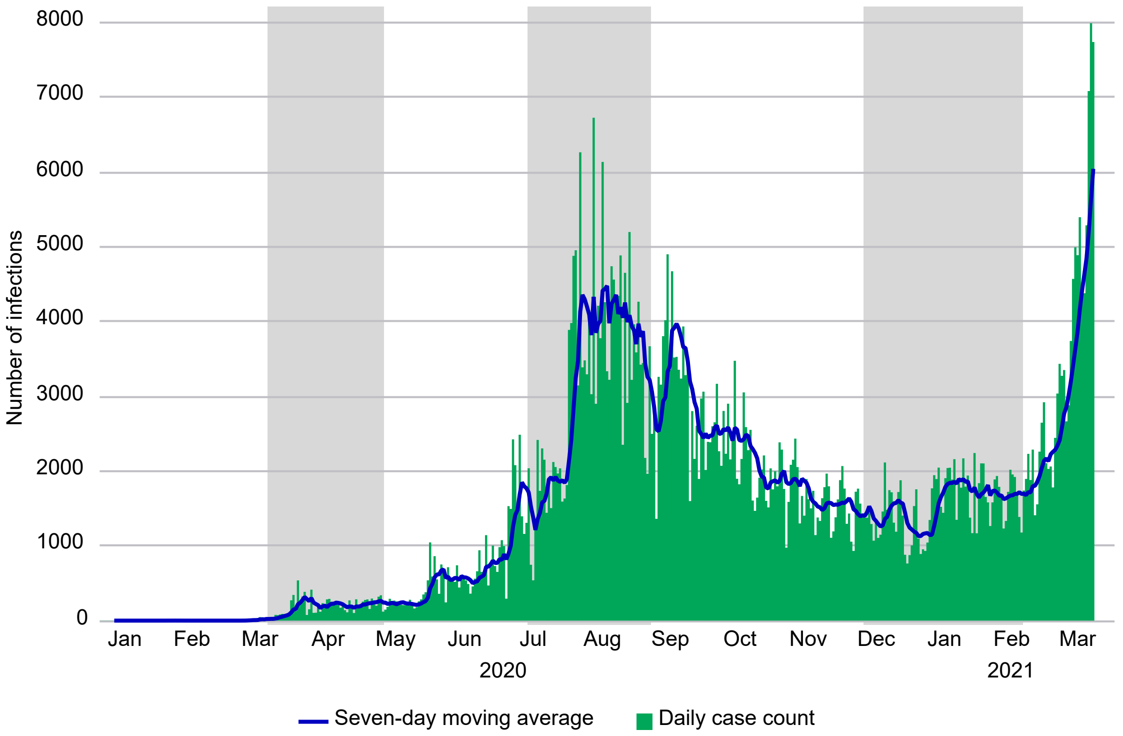
# Philippines: pace of recovery could slow

The Philippine economy isn't expected to reach its pre-crisis level until the end of 2021. Having contracted by 8.3% in 2020[1] (on a year-over-year basis), consensus is for the pace of recovery to slow further over the coming quarters. Weighing on the recovery is another wave of COVID-19 outbreak, and elevated inflation represents yet another headwind to consumption growth. Fiscal support has been limited and the Bangko Sentral ng Pilipinas' (BSP's) ability to act is hampered by the fact that headline inflation has risen above its inflation target range.[1] That said, we think the spike in inflation is only temporary in nature and the BSP could lower its policy rate later this year.

**Philippines real GDP: consensus expectations vs. pre-COVID-19 trend[2]**




**COVID-19 case counts in the Philippines remain concerning[2]**



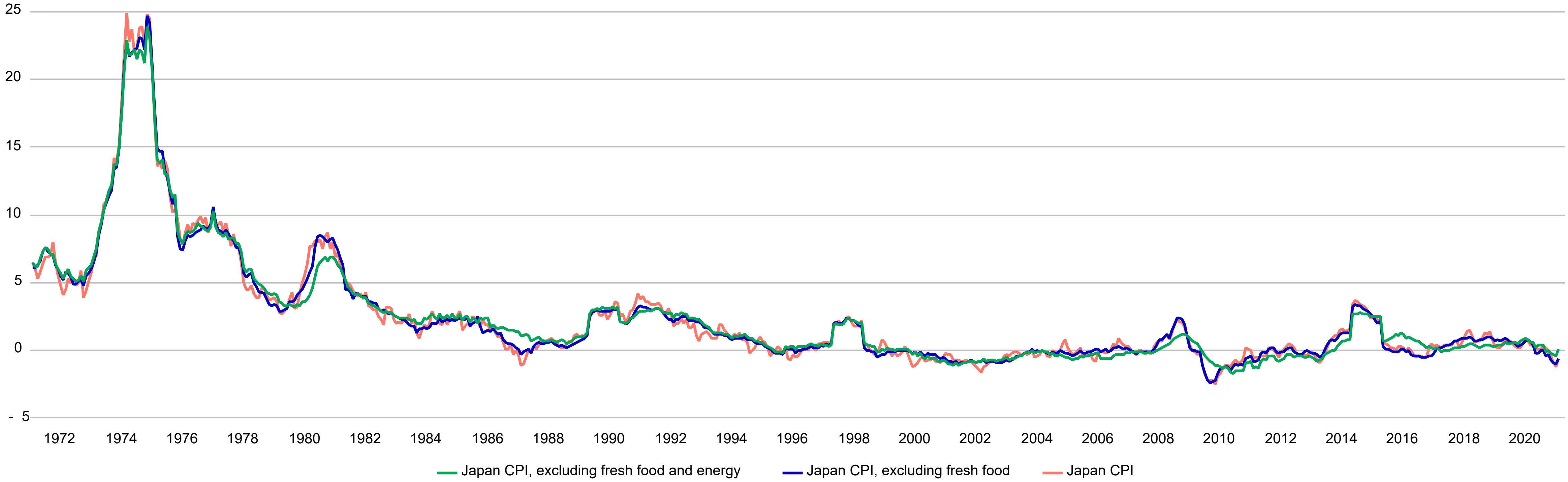



**1** Philippine Statistics Authority, March 12, 2021. **2** Macrobond, Manulife Investment Management, as of March 15, 2021. Gray areas represent recessions.

# Japan: global tailwinds to help offset domestic headwinds

Japan's economic prospects have brightened in tandem with the improved outlook for global growth. The country remains heavily dependent on trade, and the expected reopening of the global economy should deliver a tailwind to growth in 2021. The economy grew in the second half of 2020 following three consecutive quarters of contraction, thanks to a bounce in exports; domestic inflation, however, remains elusive as several measures of the Consumer Price Index (CPI) continue to hover at, or below, zero. That said, recent yen weakness—driven by widened interest-rate differentials and a deterioration in Japan's terms of trade—could translate into additional support for the economy.

**Below-target inflation remains a persistent challenge in Japan, YoY (%)**





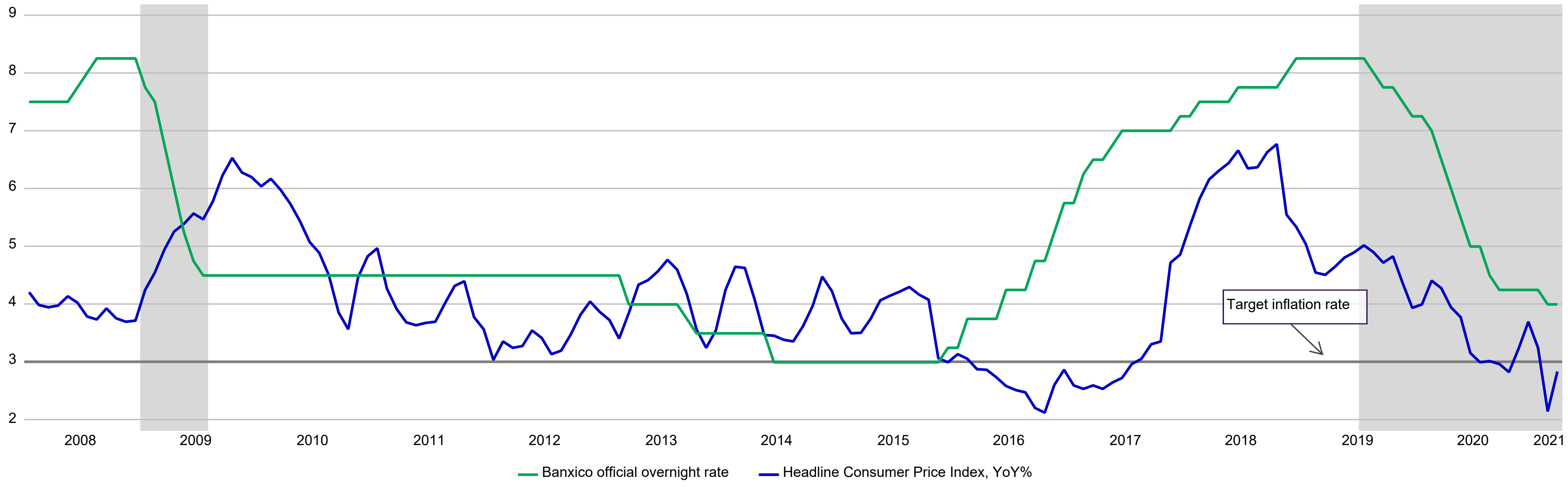

Source: Macrobond, Manulife Investment Management, as of March 3, 2021. YoY refers to year over year.

# Latin America

# Mexico: domestic policy uncertainty weighs on growth

The near-term economic outlook for Mexico is likely to remain challenged as domestic headwinds outweigh tailwinds arising from external demand and the U.S. economy's reopening. The slower-than-expected vaccine rollout will likely weigh on domestic consumption as fiscal policy remains constrained by both policy preferences and sensitivity to global financial conditions. Continuing domestic policy uncertainty is also likely to affect sentiment, leaving external demand as one of the few bright spots. Mexico's central bank, Banxico, has been dovish relative to its EM peers, maintaining a bias toward a neutral stance as others engage in monetary policy normalization.

**Banxico maintains a neutral stance despite rising inflation (%)**




Source: Macrobond, Manulife Investment Management, as of March 19, 2021. YoY refers to year over year. Gray areas represent recessions.

# Definitions

| | |
|---|---|
| Purchasing Managers' Index (PMI) | The Purchasing Managers' Index (PMI) is an indicator of the economic health of the manufacturing sector based on five major indicators: new orders, inventory levels, production, supplier deliveries, and the employment environment. It is not possible to invest directly in an index. |

# Important information

A widespread health crisis such as a global pandemic could cause substantial market volatility, exchange-trading suspensions and closures, and affect portfolio performance. For example, the novel coronavirus disease (COVID-19) has resulted in significant disruptions to global business activity. The impact of a health crisis and other epidemics and pandemics that may arise in the future could affect the global economy in ways that cannot necessarily be foreseen at the present time. A health crisis may exacerbate other preexisting political, social, and economic risks. Any such impact could adversely affect the portfolio's performance, resulting in losses to your investment.

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