A shock to the system

It’ll be some time before we know the ultimate scale and duration of the COVID-19 disruption to economic activity and corporate cashflows. But in a move reminiscent of the Global Financial Crisis, we’re encouraged to see central banks have stepped in to help by rolling out some of their heaviest artillery.

Asset class highlights

**Equity:** If the past is any guide, global equities will bottom well before a bottom in the global economy. Equity markets in 2009 hit their lows months before the worst data for employment and production.

**Fixed Income:** The U.S. Federal Reserve (Fed) will use unlimited quantitative easing to improve liquidity conditions, alleviate private sector funding pressures and limit Treasury selling by foreigners. To achieve these objectives, 10-year Treasury yields will have to trade between 0.5% and 1.25%.

**Currencies:** As the Fed takes measures to address the USD funding squeeze, the upward pressure on the USD will ease and the greenback will come under intensifying selling pressure.

**China:** To engineer a more V-shaped recovery, Chinese policy-makers will deliver more stimulus. This will include incentives to boost consumption and target infrastructure, particularly high-tech investment. Policy-makers are seeking not just a short-term cyclical revival, but progress towards long-term development objectives.
## Multi-asset outlook

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Current March 31, 2020</th>
<th>Most likely minimum of range for next 12 months</th>
<th>Most likely maximum of range for next 12 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada 3-month T-Bills rate</td>
<td>0.25%</td>
<td>0.25%</td>
<td>0.50%</td>
</tr>
<tr>
<td>Canada 2-year government bond yield</td>
<td>0.42%</td>
<td>0.25%</td>
<td>0.90%</td>
</tr>
<tr>
<td>Canada 10-year government bond yield</td>
<td>0.69%</td>
<td>0.45%</td>
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<tr>
<td>U.S. 10-year government bond yield</td>
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<td>Germany 10-year government bond yield</td>
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<td>-0.25%</td>
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<tr>
<td>Japan 10-year government bond yield</td>
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<td>0.30%</td>
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<tr>
<td>Canada 10-year real-return government bond yield</td>
<td>0.50%</td>
<td>0.10%</td>
<td>0.35%</td>
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<tr>
<td>Canada investment grade corporate spreads</td>
<td>2.42%</td>
<td>1.35%</td>
<td>2.75%</td>
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<tr>
<td>U.S. high yield corporate spreads</td>
<td>8.73%</td>
<td>5.10%</td>
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</tr>
<tr>
<td>Emerging market sovereign (USD denominated) bond spreads</td>
<td>577</td>
<td>250</td>
<td>600</td>
</tr>
<tr>
<td>S&amp;P/TSX price index</td>
<td>13,379</td>
<td>11,250</td>
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<tr>
<td>S&amp;P 500 price index</td>
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<td>Euro Stoxx 50 price index</td>
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<tr>
<td>Japan Topix price index</td>
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<td>1,550</td>
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<tr>
<td>MSCI Emerging Markets</td>
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<td>U.S. Dollar/Canadian Dollar</td>
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<td>1.4300</td>
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<tr>
<td>Euro/U.S. Dollar</td>
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<td>1.1600</td>
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<td>U.S. Dollar/Japanese Yen</td>
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<td>102.0</td>
<td>111.00</td>
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<td>U.S. Dollar/Offshore Chinese Yuan</td>
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<tr>
<td>Gold</td>
<td>1,577</td>
<td>1,500</td>
<td>1,800</td>
</tr>
<tr>
<td>Oil price, WTI (West Texas Intermediate)</td>
<td>20.48</td>
<td>20.00</td>
<td>40.00</td>
</tr>
</tbody>
</table>

Source: Thomson Reuters Datastream, CIBC Asset Management Inc.
Asset class outlook

Global overview

Global economic expansion comes to a halt
Not too long ago, the consensus view was that the global economy would remain in expansion mode throughout the year—this was before the coronavirus shock. To flatten the curve and contain the virus, social lockdowns have been enacted globally. We assume they’ll remain in place for a period before being gradually relaxed. Although transitory, the economic damage will be severe. Our baseline forecast calls for very modest global growth (0.7%) on average over the next 12 months, owing to virus containment measures. The low point in activity will likely be reached in 2020Q2.

The harsh reality is that the ultimate scale and duration of the disruption to economic activity and corporate cashflows is not yet knowable. It’s nevertheless encouraging to see that the central banks of the developed world didn’t hesitate long before rolling out some of their heaviest artillery. This was a move reminiscent of late 2008 and early 2009, which finally succeeded in stabilizing markets. In March, both the Fed and the European Central Bank (ECB) took a number of bold steps. The Fed relaxed accounting rules for banks, shifted from limited to unlimited quantitative easing (QE), launched various lending facilities and re-established swap lines with other central banks. The ECB has been just as quick to provide policy relief. In response to the deteriorating economic backdrop, the ECB prepared a comprehensive package. Overall, we’re talking about the biggest-ever expansion of the ECB’s balance sheet, potentially reaching €2.3 trillion or 20% of eurozone GDP. Other central banks, like the Bank of Canada, have also deployed colossal efforts by aggressively cutting rates and adopting unorthodox policies.

Central banks respond quickly

- **Bank of Canada**
  - Overnight rate cut from 1.75% to .25%
  - New QE asset purchasing program
  - Lending facilities
  - Stimulus projections: about 20% of GDP

- **U.S. Federal Reserve (Fed)**
  - Policy rate cut from 1.5% to 0%
  - From limited to unlimited QE
  - Multiple lending facilities
  - Repo liquidity
  - Re-established swap lines
  - Stimulus projections: about 30% of GDP

- **European Central Bank**
  - No room to cut policy rates
  - From limited to unlimited QE
  - Immediate lending facility (LTRO)
  - Easier lending conditions (TLTRO)
  - Tapping Fed swap line
  - Stimulus projections: about 20% of GDP

- **China**
  - Expected fiscal stimulus about 2-3% of GDP
  - Cutting Reserve Requirement Ratio

- **Bank of Japan**
  - No room to cut policy rates
  - Increased QE
  - Lending facilities
  - Yield Curve Control Policy
  - Tapping Fed swap line

Source: CIBC Asset Management, data as of March 30, 2020

The bulk of the new measures introduced by central banks, including corporate bond purchases, have been designed to take risk off private sector balance sheets. This is important because the recent fire sale of corporate bonds of all qualities has driven corporate capital costs up steeply. Non-financial corporations around the developed world are stuck with heavy debt loads and they absolutely need continued and easy access to credit markets—their main and cheapest funding source via debt securities issuance. Central banks had no other choice but to step in as buyers of last resort.

Central banks are not the only ones bringing out the big guns. Across the developed world, governments are also significantly loosening their fiscal policy stance by adopting important measures to cushion the hit on the economy. Together, efforts deployed on the monetary and fiscal policy fronts should do a lot to calm corporate credit markets. This removes one of the problems troubling investors and primes markets for stabilization when fears over the spread of COVID-19 begin to abate.

Until then, navigation conditions will remain difficult for global investors, with lots of uncertainty remaining regarding the evolution of the virus. That evolution will partly depend on adherence to lockdown, whether testing and tracking individuals is done broadly or not and whether the virus is seasonal and could possibly reappear later this year. There is also a great deal of uncertainty that relates to potential changes in the behaviour of economic agents. It’s very possible that life after lockdowns will not look like life before the lockdowns. On the other hand, positive developments could occur in the effectiveness of a drug and the early development of a vaccine that could provide a lift to economic activity. The bottom line is that a very wide degree of uncertainty remains at the time of this writing.
Global strategy

Search for yield will resurface
Over the first quarter of 2020, the world experienced a brutal pullback in risk assets and a powerful rally in global bonds. Still coping with COVID-19 shock, financial market volatility remains elevated. Once the dust settles, however, the global search for yield will resume. With near-zero short rates across the developed world and historically low government bond yields, investors will eventually need to shift out of safe assets and into riskier ones. At that juncture, the challenge will be to figure out where the best buying opportunities lie. From that perspective, corporate bonds will be worth considering.

Owing to the COVID-19 pandemic, the world has shifted to a new policy regime faster than we anticipated. By massively increasing the size of their asset purchasing programs, central banks will significantly increase their influence on the shape of yield curves. More importantly, central banks now have much more latitude and will buy government and corporate bonds. In effect, central banks will be working hard to cap both government and corporate bond yields to keep debt servicing costs manageable for both governments and non-financial corporations. Given the recent widening in corporate spreads, this makes corporate bonds relatively attractive. By targeting lower bond market volatility, central banks should indirectly promote lower volatility for risk assets.

Global equities

Equities repriced at record speed
For the first time in more than four years, global equity markets experienced a severe correction in early 2020, with world equity prices tumbling more than -20% from their late February cyclical peaks. Since then, market participants have struggled with the problem of pricing in multiple layers of uncertainty. These include the severity and speed of spread of COVID-19, the economic impact of social restrictions, the potential duration of the lockdowns and the ability of fiscal and monetary authorities to limit the damage to the global economy.

The key to greater certainty ultimately lies in knowing when the epidemic spread has sustainably slowed. This requires either a reduction in the speed of spread and/or the emergence of treatments/vaccines. This key feature is already at play when looking at relative equity market performance. In Asia in general, and China in particular, the number of new COVID-19 cases peaked in early February and life has been very gradually returning to a (new) normal. While Chinese equities remain in consolidation mode, they’ve been outperforming equity markets in the rest of the world since then.

While it’s premature to call for the bottoming in global equity markets, it’s important to recognize that a lot of uncertainty has already been priced in. It took just over a few months for total equity outflows to reach what took a year to happen during the 2008-09 global liquidity crisis. If the past is any guide, global equities will start bottoming well before a bottom in the global economy. Looking back at 2009, equity markets bottomed months before the bottom in coincident indicators of economic activity like employment and production. The current economic downturn is unlikely to be different, with financial market participants eventually looking through the current doom and gloom.

Global bonds

A balancing act for Treasury yields
Fueled by fears of the COVID-19 global epidemic, the rally in global bond markets intensified in the first quarter of the year. U.S. 10-year Treasury yields hit historic lows in early March and have generally been trading below 1.0% since then. Now that the U.S. Federal Reserve has cut its policy rate near zero and plans on keeping it there for a while, what’s most likely to happen at the longer end of the yield curve?

From this point on, central banks in the developed world will increasingly be using their asset purchasing programs to boost their influence on the shape of the yield curve. However, this promises to be a very difficult balancing act to perform. On one hand, aiming for a steeper yield curve makes a lot of sense from the perspective of lending institutions. It’s also a way to stimulate foreign appetite for U.S. Treasuries. On the other hand, too much of an increase at the long end of the curve would most likely imply higher borrowing costs for the heavily indebted private sector—not exactly a desired outcome.

When setting yield curve control policy parameters, the Fed will have to consider that borrowing costs for U.S. non-financial corporations have substantially increased across the whole maturity spectrum. At the time of this writing, commercial paper rates were still hovering around 2%, while investment-grade corporate bond yields were trading significantly above the levels that prevailed earlier in the year.

From this angle, the Fed is expected to use its unlimited QE promises to be a very difficult balancing act to perform. On this point on, central banks in the developed world will increasingly be using their asset purchasing programs to boost their influence on the shape of the yield curve. However, this promises to be a very difficult balancing act to perform. On one hand, aiming for a steeper yield curve makes a lot of sense from the perspective of lending institutions. It’s also a way to stimulate foreign appetite for U.S. Treasuries. On the other hand, too much of an increase at the long end of the curve would most likely imply higher borrowing costs for the heavily indebted private sector—not exactly a desired outcome.

To limit the negative impact of a flat curve on the net interest margins of lending institutions, the Fed will also have to make sure that Treasury yields don’t fall too much. However, an even bigger problem—Treasury selling by the rest of the world—lies ahead if the U.S. yield curve stays too flat. At the current juncture, the Treasury’s yearly borrowing requirements are...
already quite substantial ($1300 B) and foreigners have turned into net sellers. The result is a Treasury inventory buildup at primary dealers. Over the coming year, the U.S. federal government’s borrowing requirements will likely exceed $3000 B. Continued selling by foreigners would only aggravate the Treasury inventory overhang. From this angle, the Fed will have to limit the downside for U.S. Treasury yields. Assuming improving short-term U.S. dollar liquidity conditions over the forecast horizon, the lower band of the Fed’s new targeted range for the 10-year Treasury yield would likely stand at 0.5%. This way, foreign holders of Treasuries won’t be losing money on a hedged basis.

**The targeted range for U.S. 10 year treasury yields**

U.S. 10 year treasury yields & implicit target range

As in 2008, the Fed had to step up to the plate to restore global U.S. dollar liquidity conditions. It acted promptly by launching lending facilities and establishing swap lines—the result of important lessons learned back in 2008. Throughout 2008, both the scale of the authorized limits and the number of counterparties steadily increased as funding pressures grew. Finally, in October 2008, the Fed removed the total authorized limits. Soon after, the swap lines became big enough to start seeing improving U.S. dollar liquidity conditions in early 2009. The U.S. dollar peaked in early 2009 and embarked on a multi-year bear market for a cumulative decline of -20%, on an effective basis, between February 2009 and April 2011. Will we experience a U.S. dollar trend reversal as in early 2009? While it’s too early to say, this kind of liquidity problem is the one thing the Fed can absolutely guarantee it can overcome and it’s now doing just that. Thanks to the Fed’s efforts, the greenback will be under intensifying pressure in 2020.

**Under the microscope: Global USD funding squeeze**

The U.S. dollar is both a primary reserve asset for foreign central banks and a preferred currency for global trade and international commerce. Both factors create offshore demand for USD, which now amounts to 12 trillion USD. Companies around the world frequently access U.S. funding through the U.S. credit markets by issuing USD-denominated debt securities.

Owing to the coronavirus and oil shocks, conditions in the U.S. credit market significantly deteriorated in Q1, with credit spreads widening sharply and corporate bond yields spiking. In other words, the cost of borrowing in U.S. dollars for global businesses increased dramatically or loans became unavailable. The U.S. Federal Reserve had to step in and act as the global lender of last resort, and it acted promptly by launching lending facilities and establishing swap lines with global financial institutions.

The Fed learned important lessons in the Global Financial Crisis of 2008. Swap lines were initially established with the European Central Bank and the Swiss National Bank in late 2007. The swap lines grew until they were large enough to foster improving conditions, which occurred in early 2009. Will these facilities work to calm funding markets this time? It’s impossible to say for sure. However, the historical evidence suggests that the answer is probably yes, particularly when swap lines and lending facilities are brought into play.
Canadian Dollar
The Canadian dollar took a severe beating in March, revisiting the cyclical lows of early 2016 at around 68 U.S. cents. This happened for three reasons: first, the Bank of Canada followed the Fed’s lead and aggressively eased its policy stance. Second, the price of oil took a nosedive all the way down to $20. Finally, global U.S. dollar funding conditions sharply deteriorated.

Now that the BoC’s policy stance is roughly aligned with the Fed’s, relative BoC-Fed policy expectations won’t be playing a big role in the determination of the CADUSD bilateral exchange rate. From this point on, global USD funding conditions and the price of oil will be the key drivers. In light of the Fed’s efforts to pump liquidity into the global financial system, we should now witness continued improvement in global U.S. dollar funding conditions. This means that the outlook for the Canadian dollar is now, more than ever, tied to oil price developments. Given the hit on global demand and prevailing excess supply conditions, it’s not impossible that the oil price will weaken further over the short term. Over the longer term, however, global oil producers will have time to adjust production and the price of oil is expected to recoup some of the lost ground, fluctuating in a $30-$40 trading range. Under these conditions, the Canadian dollar will likely trade between 0.70 and 0.77 US cents (or 1.30 to 1.43 USDCAD) over the forecast horizon.

Euro
The most striking feature of the first quarter of 2020 was the sharp rise in foreign exchange (FX) volatility. This is most apparent when looking at the EURUSD bilateral rate. In late March, the euro traded at 1.10 against the U.S. dollar—not far from where it started the year. However, the road to get there was nothing short of a roller coaster ride, with a cyclical peak at nearly 1.15 in early March and a cyclical trough at 1.06 two weeks later. This spike in volatility happened because of the global U.S. dollar funding squeeze. The Fed and ECB have now taken numerous policy actions to allow for an improvement in U.S. dollar liquidity conditions. As a result, fluctuations in the EURUSD bilateral exchange will likely be increasingly dictated by fundamental determinants and should be more muted. From that angle, the EURUSD exchange rate is projected to trade between 1.06 and 1.16.

Japanese Yen
The Japanese yen experienced wild swings over the first quarter of 2020, just like the euro. While it finished the quarter at roughly the same level it started at, the ride to get there was a wild one. Now that the Fed has opened the USD liquidity tap all the way and policy rates in the developed world have converged to zero, we should witness a significant drop in FX volatility. Intensifying efforts by central banks in the developed world to increase their influence on the shape of the yield curve via their asset purchasing programs should also promote a return to a lower FX volatility environment. In such an environment, the USDJPY bilateral exchange rate should be much better behaved, fluctuating between 102 and 111.

Commodities
Saudi Arabia vs. Russia—a geopolitical game of wills
Saudi Arabia and Russia brought more supply to an oversupplied oil market in early March by walking away from their original OPEC agreement, causing prices to plummet. While low prices would normally spur demand, the impact of COVID-19 means people are staying at home, unable to consume cheap oil—overall, we’re experiencing the perfect storm for lower oil prices.

Who will blink first?
Saudi and Russia are among the lowest cost producers in the world, but can they actually sustain sub $20/barrel prices? When accounting for each country’s social programs, the true breakeven cost is around $75 and $50 for Saudi and Russia, respectively. Since oil prices are well below this level, the countries must self-fund their war on oil with foreign currency reserves. We estimate some $500B of foreign reserves for Saudi and Russia. In fact, Russia has spent the last five years, since the last oil downturn in 2014, building its foreign reserves. In 2014, we witnessed Saudi wage a war on U.S. shale oil, when it drew heavily on its foreign reserves for almost 2 years—this cost $100B per year.
2020 will be the first year since the Global Financial Crisis where oil demand growth is negative (year over year). With global social distancing in full swing and people staying at home, oil usage is grinding to a halt. At its depth, oil demand could fall some 20 MB/D* or more. While the annualized figure is still to be determined, this largely depends on virus containment and a return to normal demand consumption. Given the unknown timing on demand, one area we are tracking is Asian refining margins. With China slowly getting back to work, we should see increased gasoline and diesel consumption, which in turn should improve refining margins. China continues to be an important country to watch, not only for a potential COVID-19 recovery but also as the 2nd largest oil consuming nation behind the U.S. China drove the majority of oil demand growth pre-virus and will be key to the long-term oil demand story.

**Gold—is it doing what it’s supposed to?**
There’s a high level of uncertainty in global financial markets right now, reflecting the impact of COVID-19 around the world. In response, we’re seeing stimulus from governments and central banks via rate cuts and quantitative easing. This is meant to cushion the impact of the economic slowdown caused by the virus and eventually stimulate a return to growth. In an environment of loose monetary and fiscal policy and high uncertainty, we would expect gold to perform extremely well. But gold has declined from a high of $1,700/oz in early March to a floor of $1,470 in mid-March, before recovering to $1,630 (early April). We can point to several reasons why.

During this steep selloff in risk assets, gold was likely used as a source of cash to meet margin calls and cash demands, as investors pulled funds out of the equity market across the board. Another factor to keep in mind is gold’s inverse correlation with the U.S. dollar and interest rates. When rates go down, the U.S. dollar typically declines, gold prices rise, and vice versa. Consider the price action in March—when U.S. 10-year rates peaked in mid-March, gold bottomed, and when rates declined towards month-end, gold rose.

Looking back to 2008 and the global financial crisis (GFC) as a guide for today, we note that gold behaved very similarly during the early days of that crisis. Gold bottomed at the end of October 2008 at $720, before appreciating materially through 2009 to 2011 and reaching a peak of $1,900 in September 2011. Looking forward, with the history of the GFC in mind, we believe the set up for gold remains constructive in coming months, as stimulus measures kick in and global financial markets stabilize from the extreme volatility.

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*million barrels/day

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**Regional economic views**

**Canada**

The Canadian growth outlook
CN business cycles comparison (Real GDP, start of recession = 100)

**BoC opens the liquidity floodgates**
- Our baseline scenario calls for average real GDP growth contraction of -3.2% (y/y), a deeper contraction than in 2008.
- We’re seeing exceptional monetary and fiscal policy actions that should allow the Canadian economy to begin its recovery in the second half of the year.

The Canadian economy has been knocked down by two simultaneous shocks: containment measures aimed at limiting the propagation of COVID-19 and a severe correction in the price of oil. Our baseline scenario calls for an average real GDP growth contraction of -3.2% (y/y), a deeper contraction than in 2008. However, given the efforts deployed by Canadian monetary and fiscal authorities, the Canadian economy is expected to recover faster as compared to the last economic downturn.

Joining many other central banks, the Bank of Canada (BoC) was quick to undertake major policy actions and cut its policy rate by 150 basis points in less than a month. This was an unprecedented pace of easing for Canadian monetary authorities. Governor Poloz and his staff were quick to recognize that rate cuts alone wouldn’t be enough to cushion the hit and didn’t hesitate to open the liquidity floodgates. It did that by introducing a number of liquidity provision measures to ensure that Canadian non-financial corporations would continue to get access to funding. As such, the Bank of Canada launched various lending facilities for both financial and non-financial corporations, activated FX swap lines and launched a new Commercial Paper Purchase Program (CPPP).
The Bank of Canada has also gone where it’s never been before by launching its first Quantitative Easing (QE) program. The BoC will complete weekly purchases of at least $5 billion of Government of Canada debt across the yield curve, committing to continue the program until the recovery is well underway. Overall, the monetary policy actions undertaken are unprecedented both in terms of pace and size, a clear commitment that it will use all the arsenal at its disposal to put the Canadian economy back on its feet as quickly as possible.

Canadian fiscal authorities also announced a fiscal package of $27 billion (1.2% of GDP) in addition to deferrals of household and business taxes worth $55 billion (2.4% of GDP). The bulk of the $27 billion fiscal package also represents liquidity relief measures for households and businesses aimed at cushioning the hit to the economy. At 1.2% of GDP, discretionary spending still seems moderate relative to the economic damage and the U.S. fiscal package. At the time of this writing, the Government of Canada just announced that it will cover up to 75% of salaries for small and medium business workers, an increase from the 10% initially planned. We are expecting more of these fiscal easing measures in the coming weeks.

The exceptional monetary policy actions taken so far, and eventually more government spending, should allow growth to bottom in 2020Q2. The Canadian economy could start to recover in the second half of the year.

**IMF estimates coronavirus fiscal stimulus**

<table>
<thead>
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<th>% GDP - April 1, 2020</th>
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<tr>
<td>World average</td>
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<td>Japan</td>
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<tr>
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<td>United States</td>
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<tr>
<td>France</td>
</tr>
<tr>
<td>Italy</td>
</tr>
<tr>
<td>Germany</td>
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<tr>
<td>Eurozone +23%</td>
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Source: IMF, Thomson Reuters Datastream & CIBC Asset Management Inc.

**United States**

**After the U.S. economy’s sudden halt**

- We’re forecasting an average real GDP growth contraction of -2.7% (y/y), with the cyclical bottom reached in 2020Q2.
- We believe a V-shaped recovery is likely over the second half of 2020 and into early 2021, with lost ground completely recovered by 2021Q1.

Owing to virus containment measures, the U.S. economy is experiencing a sharp contraction in economic activity. The impact of COVID-19 on economic activity is expected to be concentrated in the first half of 2020, followed by an economic recovery starting in the second half of the year. We’re forecasting an average real GDP growth contraction of -2.7% (y/y), with the cyclical bottom reached in 2020Q2. If this forecast materializes, this economic downturn will be deeper than in 2008, but shorter in duration. The ultimate fear is for a Japanese-style protracted malaise. What are the odds of getting more of a U-shaped recovery than a V-shaped one?

In our view, a U-shaped recovery remains an alternative, not a principal scenario at this stage, because of the bold measures taken by U.S. monetary and fiscal authorities. On the monetary policy front, the Fed rapidly acknowledged this risk by taking a number of important policy actions. It started by delivering additional policy rate cuts, bringing the fed funds rate back down to the level it was before the Fed’s tightening campaign started in late 2015.

The Fed didn’t stop there, recognizing that something more than rate cuts was urgently needed. To ensure that the U.S. economy won’t sink any deeper and drag along the bottom for a protracted period, the Fed has been acting as the lender of last resort by providing the liquidity needed to avoid a prolonged U.S. dollar liquidity squeeze. A USD squeeze was not an option for the Fed. U.S. non-financial corporations are stuck with a heavy debt load (155% of GDP) and they absolutely need continued and easy access to credit markets—their main and cheapest funding source via debt securities issuance.

As in 2008, the Fed acted promptly by taking many actions on the liquidity front. It beefed up its repo operations with primary dealers and moved from limited to unlimited QE asset purchases. It also launched a number of lending facilities while establishing swap lines. The swap lines are obviously important, but the launch of lending facilities is also an important and essential development. The key difference between the current situation and 2008 is that the Fed learned an important lesson during the 2008 liquidity crisis, which is not to wait long before going for the bazooka.

To say the least, U.S. fiscal authorities weren’t gun-shy either. The fiscal package adopted by the U.S. government amounts to nearly $2 trillion (or 9.5% of GDP). To be clear, the bulk of the announced fiscal measures amounts to liquidity relief for households and businesses, a necessary policy response to the virus-driven negative supply shock hitting the U.S. economy. As such, this hardly qualifies as stimulus as it aims at cushioning the hit, but it should be large enough, in our opinion, to do exactly that.

**BOTTOM LINE:** in the absence of a crystal ball, forecasting the shape of the upcoming U.S. recovery is a perilous exercise. Having said this, given the aggressive policy actions taken by U.S. monetary and fiscal authorities, we believe the U.S. economy is more likely to experience a V-shaped recovery over
the second half of 2020 and extending into early 2021. Lost ground should be completely recovered by 2021Q1.

Europe

Eurozone & COVID-19 hit: Bad timing
• We’re forecasting average real GDP yearly growth will contract to -3.9%. This is deeper than the 2008 recession but should be followed by a faster economic recovery.
• The encouraging news is that the European Central Bank was just as quick as the Fed to provide policy relief—this should foster an upturn in the second half of 2020.

Earlier this year, hopes were running high that the German-led eurozone economic slump of 2019 would turn into a German-led recovery moving into 2020. The government-imposed lockdowns to limit the spread of the coronavirus have now dashed all hopes for a recovery. Our baseline forecast calls for an economic downturn in the eurozone, with average real GDP yearly growth at -3.9%. This amounts to a deeper contraction than during the 2008 recession, which should be followed by a relatively faster economic recovery.

These numbers are early estimates. Just how deep a recession the eurozone economy will experience depends on the intensity of the tightening in financial conditions. So far, the tightening over the first quarter of 2020 has been quite severe. In terms of magnitude, we are talking about a tightening situation roughly half the size of the one experienced in 2008. In terms of intensity, however, this shock has been 18X faster than in 2008-09.

The encouraging news is that the European Central Bank (ECB) was just as fast as the Fed to provide policy relief. In response to the deteriorating economic backdrop, the ECB prepared a comprehensive package, including a temporary new longer-term refinancing operation (LTRO) to provide immediate liquidity to the financial system. It also eased the lending terms of the TL TRO III program, which should be very supportive for eurozone banks. Last but not least, it considerably increased its QE asset purchasing capacities by launching a new Pandemic Emergency Purchase Program (PEPP) that comes with an overall envelope of €750 billion. Overall, we are talking about the biggest expansion of the ECB’s balance sheet ever, potentially reaching €2.3 trillion or 20% of eurozone GDP. Governments in the eurozone are also significantly loosening their fiscal stance by adopting important measures to cushion the hit on the economy.

Looking forward, even if the eurozone economy switches back to recovery mode as expected, the threat of deflation is likely to resurface. The problem is that, with real GDP growth in negative territory and deflation’s return, government revenues will take a severe hit—and in the context of increased government spending. The result will be rapidly widening fiscal deficits and fast-rising government borrowing requirements. These are all the ingredients for another eurozone fiscal crisis. To avoid that undesirable outcome, the ECB will need to monetize the near totality of the new government debt issuance, increasing its QE capacity accordingly.

BOTTOM LINE: It’s too early to know for sure just how long and deep the eurozone’s economic downturn will be. However, the policy easing provided by the ECB and national governments should allow for a bottoming in 2020Q2 and a return to recovery mode over the second half of the year.

China

Targeted stimulus
• Reflecting a base-year effect induced by the shock of the virus outbreak, we expect GDP growth to average +8% over the forecast horizon.
• The economic downturn taking place in the rest of the world has important implications for China’s exporters—they’ll soon need to cope with much weaker foreign demand.
• We expect China to deliver a fiscal package of about 2-3% of GDP later this year, much less than advanced economies.

Asia to recover first
Business cycle comparison (% change from peak in activity)

The shutdown of the Chinese economy that followed the COVID-19 outbreak has been a substantial shock, much larger than experienced during the global financial crisis. Since 2008, China has been among the most proactive countries to deliver timely and adequate stimulus when needed. However, it’s currently been a laggard on that front, sticking instead to its
financial stability agenda and hoping for a quick rebound in activity.

While the high-frequency data is signaling that an economic recovery is already underway, it by no means implies that China is permanently shifting back to higher gear. The economic downturn taking place in the rest of the world has important implications for China’s exporters—they’ll soon need to cope with much weaker foreign demand. As a result, Chinese businesses (particularly SMEs\(^1\)) should remain cash-starved and could be forced to lay off workers. This would magnify the weakness of aggregate demand and bring some financial instability.

To avoid costly spillovers and engineer a recovery that is more V-shaped, Chinese policy-makers will have no choice but to deliver more stimulus. We expect China will deliver a fiscal package of about 2-3% of GDP later this year, much less than advanced economies. While the package would include several fiscal incentives to boost consumption, it would target infrastructure, with a focus on high-tech investment. The high-tech component of the stimulus is more unconventional and takes more time to design, hence the delay. The high-tech stimulus focus will likely be aligned with the implementation of the 5G network and with longer-term objectives of moving up the value chain. In short, the policies implemented by Chinese policy-makers won’t just target a short-term cyclical revival but will also be aligned with long-term development objectives.

Reflecting a base-year effect induced by the shock of the virus outbreak, we expect GDP growth to average 8% over the forecast horizon.

\(^1\)Small and medium enterprises
Alternative scenarios

Accelerated Recovery (25%)

In this relatively more upbeat alternative scenario, the efforts deployed by monetary and fiscal authorities around the world are successful in limiting the economic fallout from the coronavirus. Also, and just as important, the social lockdowns globally enacted are successful in flattening the curve and containing the virus. The economic consequences are twofold—the contraction in global economic activity is less severe and the global economy gets back on its feet more rapidly than in our baseline scenario.

In the context of a faster-improving global economic landscape, the recovery in risk assets would be more strongly supported, thanks to a rosier earnings growth outlook. A pullback in global bond markets would likely materialize, but the potential upside for global bond yields would be limited owing to heavier bond purchases by central banks. With abating global U.S. dollar funding pressures, the U.S. dollar would likely embark on a broad-based cyclical downtrend.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Less Favourable</th>
<th>More Favourable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accelerated Recovery</td>
<td>U.S. dollar</td>
<td>Global equities</td>
</tr>
<tr>
<td></td>
<td>Long-dated G10</td>
<td>Emerging currencies</td>
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<tr>
<td></td>
<td>bonds</td>
<td>High yield bonds</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Commodities</td>
</tr>
<tr>
<td>Protracted Recovery</td>
<td>Global equities</td>
<td>Gold</td>
</tr>
<tr>
<td></td>
<td>Industrial metals</td>
<td>U.S. dollar</td>
</tr>
<tr>
<td></td>
<td>High yield bonds</td>
<td>U.S. Treasuries</td>
</tr>
</tbody>
</table>

Protracted Recovery (25%)

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

In this scenario, there is very little room for an improvement in global financial conditions. The recovery in risk assets would be significantly delayed, leaving global investors stuck in an environment of heightened uncertainty and elevated market volatility. Global bond markets would be expected to shift into rallying mode, but with limited downside for bond yields, given already low yield levels. Despite the Fed’s efforts to provide U.S. dollar liquidity to the rest of the world, global U.S. dollar funding pressures continue, keeping the U.S. dollar well supported. In this environment, the bull run in the price of gold would still have legs.
Economic forecasts (next 12 months)

<table>
<thead>
<tr>
<th>Region</th>
<th>Current GDP(^4)</th>
<th>GDP - Consensus</th>
<th>GDP - CAM View</th>
<th>Current Inflation(^5)</th>
<th>Inflation - Consensus</th>
<th>Inflation - CAM View</th>
<th>Policy Rate - CAM View</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>1.5%(^4)</td>
<td>1.1%</td>
<td>-3.2%</td>
<td>2.2%</td>
<td>1.8%</td>
<td>1.4%</td>
<td>Near 0%</td>
</tr>
<tr>
<td>United States</td>
<td>2.3%</td>
<td>1.3%</td>
<td>-2.7%</td>
<td>2.3%</td>
<td>1.9%</td>
<td>1.4%</td>
<td>Near 0%</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.0%</td>
<td>-0.6%</td>
<td>-3.9%</td>
<td>1.2%</td>
<td>1.2%</td>
<td>0.8%</td>
<td>Near 0%</td>
</tr>
<tr>
<td>China</td>
<td>6.0%</td>
<td>4.5%</td>
<td>8.1%</td>
<td>5.2%</td>
<td>3.0%</td>
<td>1.0%</td>
<td>Cutting RRR(^3)</td>
</tr>
<tr>
<td>Japan</td>
<td>-0.7%</td>
<td>-0.4%</td>
<td>-2.5%</td>
<td>0.5%</td>
<td>0.5%</td>
<td>-0.9%</td>
<td>Near 0%</td>
</tr>
<tr>
<td>World</td>
<td>3.0%</td>
<td>2.7%</td>
<td>0.8%</td>
<td>3.4%</td>
<td>2.8%</td>
<td>1.8%</td>
<td>-</td>
</tr>
</tbody>
</table>

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

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

Long-term capital market returns (10 year)

The COVID-19 pandemic and oil supply shocks have had swift and major ramifications for the global economy and financial markets. These shocks also have important implications for expected long-term asset returns. In January, we published the latest edition of our annual Long-Term Capital Market Returns research paper with projections for a number of asset classes. The conclusions made for relatively sober reading. Most asset classes were overvalued, and expected returns were commensurately low. That outlook has been significantly altered by subsequent developments. For wealth management, one of the few positives to be drawn from the current situation is price corrections sow the seeds of the next investment opportunities. In this sense at least, this period of market dislocation is no different than previous episodes.

Reflecting the magnitude of changes to the outlook for expected returns, this is a supplement to our annual paper. Long-term expected returns are determined by two, broad drivers: slow-moving fundamental forces that shape the global economy and changes in current asset prices. Both have been significantly impacted by the combined pandemic and oil shocks. In this supplement, we focus on the change in expected returns due to price changes.

We are deferring a thorough analysis of the impact of changes in central bank policy caused by the current crises, and related changes in the investment and saving decisions of governments, firms, and individuals. These potential changes could affect the long-term paths of productivity, corporate earnings, and interest rates.
Long-term capital market returns (10 year) : Updated forecast

These revisions provide an interim assessment. Extensive policy actions have ensured that risks have become more symmetrical. A definitive turn higher in investor risk appetite and the price of risk assets will only become more likely when two conditions are met. First, the virus spread is clearly under control globally and second, market return expectations have corrected enough to reflect the scale of the gathering global recession. We don’t believe either condition exists at this point.

- Expected long-term annualized equity returns have increased substantially as a result of price corrections. All markets in our investment universe have become more attractive than they were in January.

- Some equity markets remain more attractive than others and the relative return outlook is unchanged. Emerging markets, broadly, began the year at relatively cheap levels, and have become cheaper. The U.S. and other advanced economy equity markets began 2020 in overvalued territory. These markets have corrected back closer to fair value.

- Valuations of other risk assets have also become more attractive. These include developed market (DM) corporate and high yield bonds, and emerging market debt.

- Expected long-term returns for DM sovereign bonds have decreased. Yields, which are a good proxy for long-term returns, have fallen to unprecedented levels due to an investor flight to safety and newly announced quantitative easing (QE) by major central banks. For the first time, this includes the Bank of Canada. The flatness of DM yield curves means investors will not be rewarded for taking duration risk.

- Low nominal and real yields render DM bonds less capable of performing a long-term stabilizing role in investor portfolios. Other complementary investments that offer protection during equity corrections will become increasingly relevant. This will include gold, as well as alternative strategies that include allocations to a range of diversifying asset classes.

### Long-term expected returns

10 year average expected returns (%)

<table>
<thead>
<tr>
<th></th>
<th>2020 annual update-January 2020</th>
<th>April 2020 interim update</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. bonds</td>
<td>0</td>
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</tr>
<tr>
<td>Canada bonds</td>
<td>0.5</td>
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</tr>
<tr>
<td>U.S. corporate</td>
<td>4.3</td>
<td>4.9</td>
</tr>
<tr>
<td>Canada corporate</td>
<td>3.8</td>
<td>-1.3</td>
</tr>
<tr>
<td>U.S. equity</td>
<td>6.8</td>
<td>6.6</td>
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<tr>
<td>Global equity</td>
<td>8.1</td>
<td>8.6</td>
</tr>
<tr>
<td>EAFE® Equity</td>
<td>10.3</td>
<td>11.0</td>
</tr>
<tr>
<td>U.S. high yield</td>
<td>13.6</td>
<td>10.2</td>
</tr>
<tr>
<td>Canada equity</td>
<td>11.1</td>
<td>8.7</td>
</tr>
<tr>
<td>EM bonds (local currency)</td>
<td>12.8</td>
<td>11.9</td>
</tr>
<tr>
<td>EM equity</td>
<td>13.4</td>
<td>13.8</td>
</tr>
</tbody>
</table>

Source: CIBC Asset Management Inc. based on data available April 1, 2020