FRANKLIN TEMPLETON

SUMMARY OF

GLOBAL MACRO SHIFTS

with Michael Hasenstab, Ph.D.

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ASIA AT THE FOREFRONT: THE WORLD'S UNEVEN EMERGENCE FROM COVID-19

This is a summary of the full paper. Global Macro Shifts is a research-based briefing on global economies featuring the analysis and views of Dr. Michael Hasenstab and senior members of Templeton Global Macro (TGM).

Overview

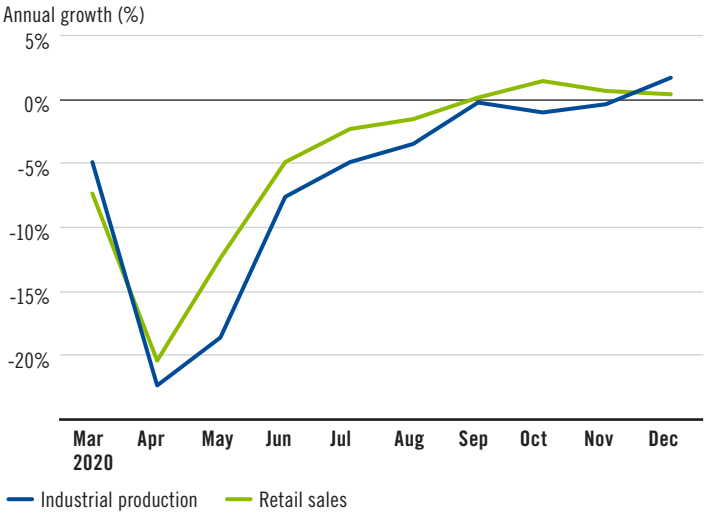
Early in 2020, at the onset of COVID-19 related lockdowns, we noted that the world was entering an economic downturn which would rival, if not surpass, the 2008 global financial crisis (GFC) in economic and social magnitude. Faced with a global pandemic reminiscent of that experienced in 1918, governments (to varying degrees) embraced mobility restrictions and public health measures intended to slow the virus's deadly spread. At the same time, in an attempt to offset the devastating impacts of a resulting sharp drop in consumer spending, political leaders of all major developed economies embraced unprecedented accommodative shifts in fiscal and monetary policy. These policy responses have brought much needed support to those most impacted by COVID-19 related lockdowns, as well as to financial markets, helping to partly offset the sizable macroeconomic impacts of the pandemic.

Ultimately, we saw a strong sequential economic recovery in the third quarter of 2020 as some of the more severe mobility restrictions that were put in place to deal with the pandemic were scaled back. However, more recently the high frequency indicators around the world have indicated that the so-called "V-shape" recovery has eased, particularly as more countries faced new COVID-19 waves and some mobility restrictions were re-introduced. Now, the development and the distribution of COVID-19 vaccines promises to be a game changer that will bring about a rapid acceleration of economic activity as health risks are mitigated and mobility returns.

Nonetheless, the latest forecasts from the International Monetary Fund (IMF) in January 2021 indicate that growth is still estimated to have been deeply negative in 2020, and that the recovery is expected to be slow. Specifically, the IMF estimates global growth to have fallen 3.5% in 2020 and expects it to rise 5.3% in 2021. Except for China, the world

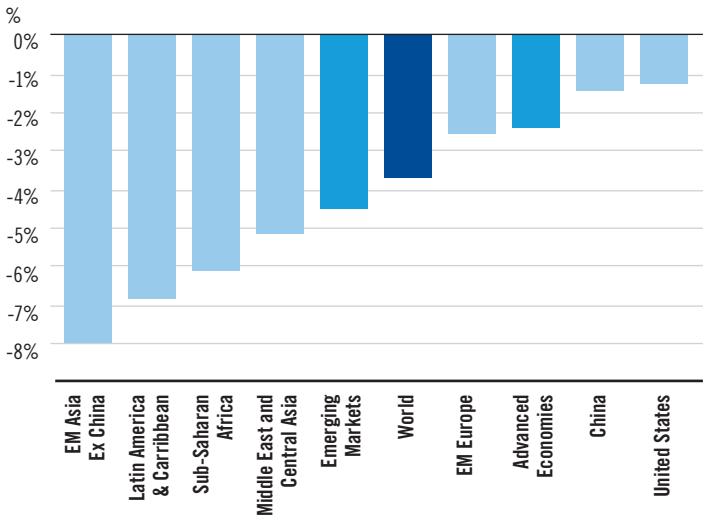
ECONOMIC ACTIVITY SUFFERED UNEVENLY DURING THE PANDEMIC

Exhibit 1: Annual industrial production and retail sales growth (sample average across 34 economies)
March 2020–December 2020



Sources: Bloomberg, National Sources, TGM Analysis.

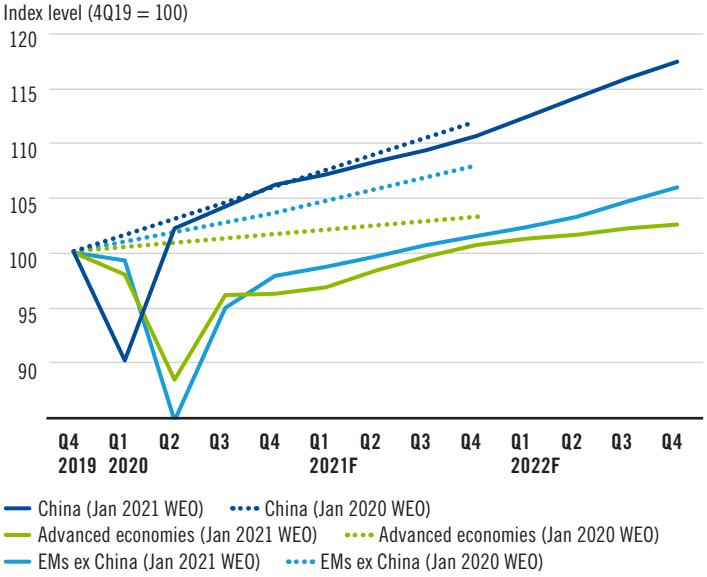
Exhibit 2: Gross domestic product (GDP) losses relative to pre-COVID-19 levels by region
2022 forecast



Source: IMF World Economic Outlook (WEO), January 2021. There is no assurance that any forecast, estimate or projection will be realized.

GLOBAL GROWTH FORECASTS REMAIN WELL BELOW PRE-PANDEMIC TRENDLINES

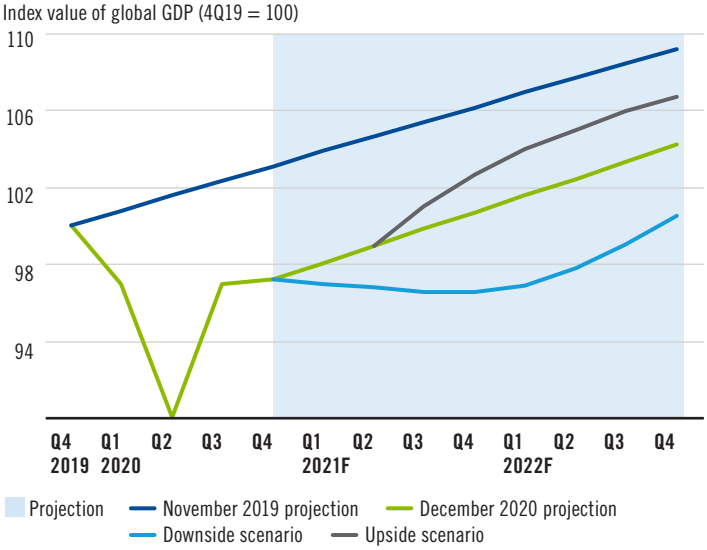
Exhibit 3: IMF growth forecasts for advanced and emerging economies
Fourth quarter 2019–Fourth quarter 2022F



F=Forecast.

Source: IMF WEO, January 2021. There is no assurance that any forecast, estimate or projection will be realized.

Exhibit 4: OECD world GDP forecasts
Fourth quarter 2019–Fourth quarter 2022F



F=Forecast.

Source: OECD. There is no assurance that any forecast, estimate or projection will be realized.

is barely expected to reach its pre-pandemic fourth-quarter 2019 level until the end of 2021. Still, the IMF expects that most economies will remain well below their pre-pandemic trend throughout 2022. For its part, the OECD (Organisation for Economic Co-operation and Development) projects that while global growth may pick up in the medium term, it is unlikely that we will regain the ground lost relative to the world economy's pre-COVID-19 trend.

Across the world, even with massive job retention schemes in major developed markets, unemployment rates remain elevated. In addition, the presence of massive employment schemes suggests that these unemployment levels, particularly in Europe, could in fact rise in the coming quarters, absent continued fiscal support.

These impacts have not been felt evenly. Rather, the negative consequences of lockdowns have disproportionately impacted lower-income jobs. A September 2020 study from the Pew Research Center indicated that 47% of US lower-income earners (or someone in their household) had either lost a job or had to take a pay cut due to COVID-19, while the same was true of only 32% of upper-income recipients. A similar disparity was seen in the proportion of those who were able to go back to the job they had been laid off from due to COVID-19. Among middle- and upper-income persons, 42% found themselves back in their previous position in September, while only 24% of lower-income earners could say the same.

Around the world, we are seeing similar impacts. In an October publication, the World Bank estimated that global extreme poverty is expected to rise in 2020—by 88 to 115 million people—for the first time in over 20 years as the disruption of the COVID-19 pandemic compounds the forces of conflict and climate change, which were already hindering poverty reduction.[1]

Policymakers around the world have highlighted the uneven impact of the COVID-19 recession. In its World Economic Outlook (WEO) Update, the IMF stated that "the burden of the crisis has fallen unevenly across groups: workers with less education, women, youth, those in contact-intensive sectors, and those informally employed have suffered disproportionate livelihood and income losses." There is a growing consensus that policy support, including fiscal and monetary, will need to address not only the aggregate output and income losses but also to help mitigate and reverse disparate impacts of COVID-19. As the recent IMF Fiscal Monitor Update spells out: "Budget needs are expected to remain sizable…as economies emerge from the pandemic amid a disproportionate adverse impact on the poor, women, and informal workers."

Additionally, there is significant variation in how countries have handled the pandemic, managed fiscal and monetary policy, and supported their economies. While the euro area and the US contend with deepening fiscal deficits and excessive monetary accommodation, areas of Asia are in stronger fiscal

shape, with greater growth potential, robust trade dynamics and current account surpluses. The decade ahead appears likely to be characterized by the ascendent economic and political strength of China, with regional trade and asset ownership becoming increasingly denominated in the Chinese yuan (CNY).

In this edition of Global Macro Shifts, we explore the macroeconomic impacts of the COVID-19 pandemic, the consequences of extraordinary policy responses to the crisis and the economic outlook for a post-pandemic recovery. The paper is organized as follows: Section 1 covers the US economic outlook for 2021 by reviewing the damage endured to date, the uneven impacts on demographics within the workforce and the economic recovery's dependence on further government support. Section 2 discusses the implications of the economic policy choices of the US for the rest of the world from the vantage point of macroeconomic theory. Section 3 draws on these foundations and translates theoretical principles into economic reality by laying out our expectations for economic and financial developments of other large countries and regions. Finally, we conclude the paper with a summary of our views.

1. US economic outlook for 2021

The United States is recovering from the impacts of the pandemic. Activity in late 2020/early 2021 is likely to be somewhat restrained by a new COVID-19 wave of infections, but the trend remains positive. The rollout of vaccines is likely to provide a boost to sectors most affected by reduced mobility (such as personal health care services, retail and hospitality), particularly toward the second half of 2021 onward. The United States is administering roughly 1.5 million vaccines per day (as of February 2021), with the trend remaining positive.

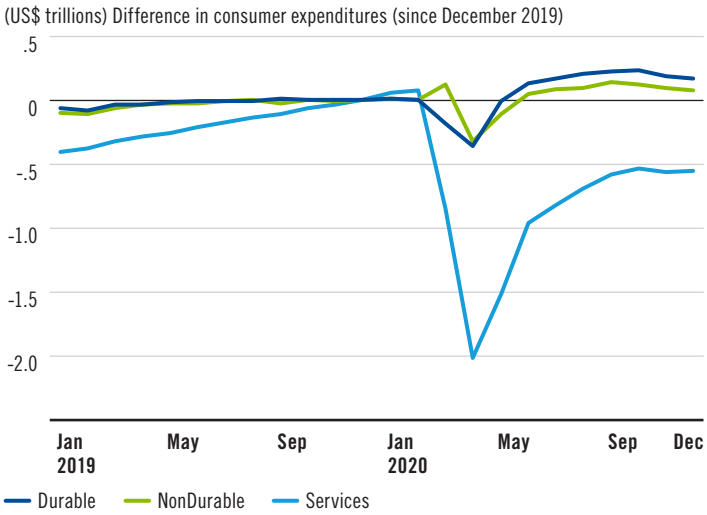
In terms of consumer demand, goods consumption has done better than services. There are signs that pent-up demand in goods production remains a key driver, with private investment in capex (capital expenditures) and residential construction remaining quite robust. As the vaccines are more widely distributed and overall economic activity picks up pace, we expect that pent-up demand in services should drive growth even more robustly into the second half of 2021.

COVID-19 shock driving up inequality

Even as aggregate gross domestic production recovers, there are still many sectors that remain hampered. In particular, employees in lower-wage industries remain unable to return

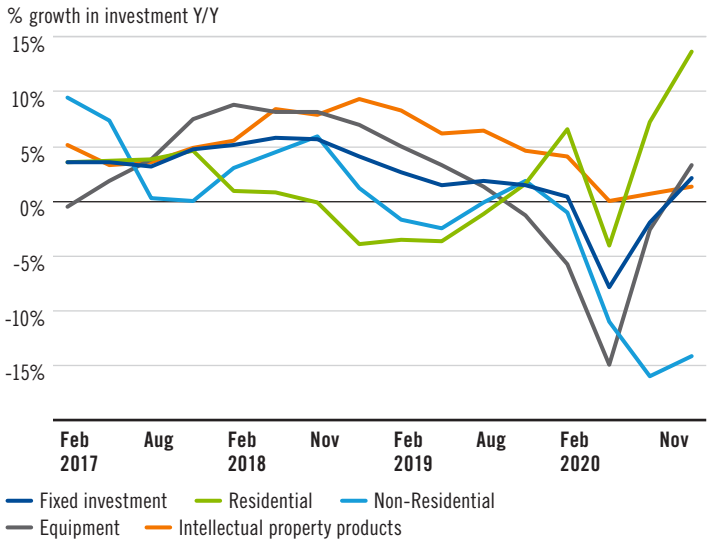
GROWTH HAS BEEN LED BY GOODS CONSUMPTION, WITH SERVICES LAGGING

Exhibit 5: Changes in consumer expenditures since December 2019
January 2019–December 2020



Source: US Bureau of Economic Analysis.

Exhibit 6: Growth in US investment by category
February 2017–November 2020



Source: US Bureau of Economic Analysis.

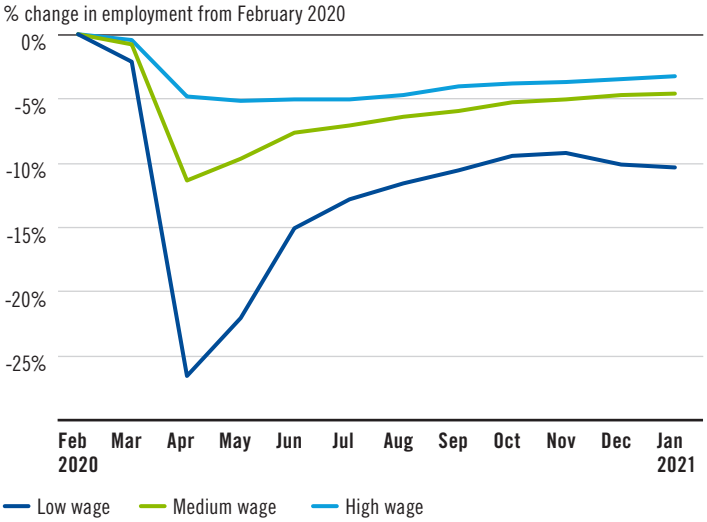
to work. This will likely further drive up inequality and elicit further fiscal and monetary support from the federal government. The US Federal Reserve (Fed) has adopted a more inclusive flexible average inflation-targeting (FAIT) regime that takes a broader emphasis on full employment and downplays deviations from an average measure of unemployment for the economy.[2] By taking a broader approach, the Fed expects that interest rates will remain low until inflation remains consistently at its 2% target, extending monetary support to extend the benefits of an economic expansion[3] more broadly.[4] US Treasury Secretary Janet Yellen has also made explicit the need for further fiscal spending to address the disparate impact of the pandemic, particularly on African American employees and business owners.[5] Yellen also noted that the fiscal support would not just need to address the COVID-19 pandemic, but also persistent disparities that existed prior to the recent recession.[6] The next subsections discuss the rise of inequality documented in the Bureau of Labor Statistics' establishment survey (i.e., the data showing nonfarm payrolls and earnings) and the household survey (i.e., the data showing unemployment and participation rates).

Private employment by industry: COVID-19 impact greatest in low-wage industries

In Exhibit 7, we divide nonfarm private (NFP) payroll employment into low-wage, medium-wage and high-wage industrial categories by using the 2019 average hourly earnings for each industry. NFP in low-wage industries represented 37.8% of private employment, 52.2% were in medium-wage industries, and 10% were in high-wage industries.

LOW-WAGE INDUSTRIES HAVE SUFFERED A DISPROPORTIONATELY HIGHER LOSS OF EMPLOYMENT

Exhibit 7: Change in US employment by wage group
February 2020–January 2021



Source: US Bureau of Labor Statistics, TGM Analysis.

Household employment data show Black and Hispanic employment remains more depressed

The NFP data do not give much granularity regarding the identity of the employees (just industry and sex). However, the household data give more information (although the data is more volatile). We know that unemployment rose rapidly and fell, but we also know that participation rates have changed as well, as many workers exited the labor market to care for children, became discouraged, etc. Looking at the employment-to-population ratio provides a cleaner indication as to the makeup of the decline in total employment (and earnings) regardless of whether the lack of income is categorized as unemployment (actively seeking for a job) or not ("voluntary" exits). Looking at these data, we see that Hispanics experienced the largest drop in employment and have recovered slowly, Asians and Blacks fell a bit less but Asians recovered faster. Whites experienced the smallest declines, and have recovered the most.

Female employment more depressed than male employment and slower to recover

At an aggregate level, female employment has declined more than male employment. We know that women have been negatively affected both because they are relatively more employed in industries that have been more affected by the pandemic (education, retail and health care) and because they have in greater numbers stepped up to care for and educate children who remain largely at home because of COVID-19 restrictions.[7,8] According to NFP data as of December, female employment was 7.3% below its February 2020 level, while male employment was 5.9% below its February 2020 level. The household survey, on the other hand, showed much more similar declines in employment to population levels by sex.

Government assistance bolstered income and spending in 2020 but waned at year-end

Fiscal support to households was strong during the initial stages of the pandemic due to very generous CARES Act fiscal package transfers made via checks, as well as through expansions of unemployment insurance (UI) programs and other federal programs. However, the support waned through the end of 2020 even as many people remained unable to return to work. The US$900 billion in additional support that was approved at the end of 2020 may not be sufficient to replace the income losses, particularly at the lower end of the income distribution.

How was the lost employment income "made up"?

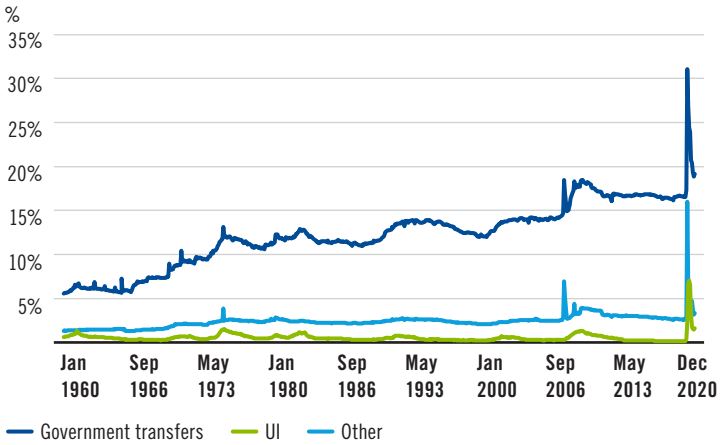
The personal savings rate jumped in April despite very sizable employment losses. This was due to both a large consumption reduction (on account of the lockdowns and the uncertainty) and a large income increase. In cumulative terms, the losses in income have been more than made up by large transfers from the government (mostly through UI payments and checks to households). However, the level of transfers had declined significantly as of November and may not be sufficient to cover the ongoing income losses for those that remain affected by the pandemic and its scarring.

Expect further monetary and fiscal support

In the near term, we expect the US economy to continue to recover, picking up speed as the vaccines are rolled out and the more affected sectors open up. The COVID-19 shock has increased inequality greatly, and some sectors will remain affected for a while. We expect fiscal and monetary policy to continue to support the economic recovery. We also expect that policymakers will keep the support going to attempt to reverse the impacts on inequality and address pre-existing issues as well. Over the medium term, US growth will also benefit from a more flexible immigration policy framework that supports labor supply growth. Additionally, a more flexible foreign policy should support investment and growth. In the next section, we go back to economic principles to set up a framework that allows us to make some predictions regarding how US economic evolution will impact the rest of the world.

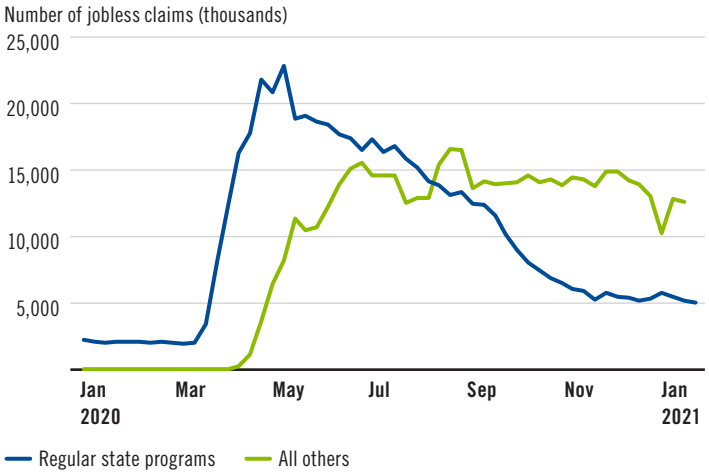
GOVERNMENT TRANSFERS CONTINUE TO REPRESENT A SIGNIFICANT SHARE OF PERSONAL INCOME AMID ELEVATED LEVELS OF CONTINUING JOBLESS CLAIMS

Exhibit 8: Percentage of personal income that comes from government transfers
January 1960–December 2020



Source: US Bureau of Economic Analysis.

Exhibit 9: US continuing jobless claims
January 2020–January 2021



Source: US Department of Labor.

2. What the macroeconomic textbooks say about the global outlook

Even though a pandemic is not a standard topic in macroeconomic textbooks, the effects of external shocks and the responses of fiscal and monetary policies to these shocks, including their implications for growth, interest rates and currency developments, certainly are.

Decision-making under uncertainty: vaccines are a potential game changer

At the time of this writing, a number of vaccines have been rolled out for some groups of people. This is a milestone for this health crisis and the first important step for economic normalization. We are well aware of the logistical challenges to vaccine production and distribution, especially for developing countries. However, our baseline is that distribution will continue to roll out in the coming months and reach the majority of the world population. We believe this will significantly lower the economic and health uncertainty.

Economists Avinash Dixit and Robert Pindyck provided the first detailed theoretical approach to the capital investment decisions of firms through the option value of waiting.[9] The authors argued that given an investment decision is irreversible, a firm faces two options: invest at time *t* or invest at time *t+1*. By investing at *t+1*, the firm will have more information about the business, market demand, etc. between *t* and *t+1*. In other words, there is value in waiting, and this value is dependent on how valuable the information will be. Of course, the higher the uncertainty about the future, the higher the value of waiting. Firms tend to delay investment. Consumers tend to delay consumption. This is analogous to the theory of financial market options.

With the vaccines becoming available, uncertainty will diminish greatly. Using the terminology of Dixit and Pindyck, the value of waiting drops. This encourages investment and consumption today, the latter of which, as we have discussed earlier, has been severely suppressed by the pandemic.

International trade economics: policy stimulus impact

One way to think about the economic impact of fiscal and monetary stimulus is through the model devised by economists Robert Mundell and Marcus Fleming (M-F model). The M-F model studies the equilibrium relationship between the goods market and the money market in an open economy setting.

The original version of the model is based on a small open economy where the world interest rate is fixed by the world financial market. One of the important contributions from the model is often named "policy trilemma": an economy cannot simultaneously maintain a fixed exchange rate, free capital flow and independent monetary policy.

To understand the economic dynamic of the US, a large open economy setting is needed. Specifically, the world interest rate is no longer a given or constant, but rather is a function of US economic policy. The rest of the world will take the US policy as given, and their economies will adjust accordingly.

As we discussed in Section 1, we believe in the coming years additional fiscal and monetary stimulus are likely. Below we discuss the economic impact through the logic of the M-F model. We assume for simplicity that the price level is fixed. This is generally true in the short run. To disentangle the separate effects of fiscal and monetary policy, we present the model first only with fiscal policy, adding monetary policy later before reaching our final conclusion for this US policy mix.

Introducing fiscal stimulus but keeping monetary policy unchanged at first

To increase spending, the government has to use its past savings or borrow. In either case, this lowers the amount of national saving. As a result, upward pressure is put on interest rates. As US interest rates rise, there are two effects: (1) it lowers the level of investment and (2) it encourages capital inflow as US interest rates become comparatively more attractive than those of the rest of the world. An increase in capital inflow leads to US dollar (USD) appreciation, which will lower net exports. Both weaker investment and net exports will partially offset the stimulus effect of fiscal spending. This is called the crowding out effect. How much of an offset depends on the elasticity of corresponding variables. In most cases, the net effect of fiscal stimulus is still positive to output.

As output increases, US consumers increase consumption, including consumption of imports. Adding the effect of USD appreciation, the US trade balance deteriorates. Another consequence of US fiscal spending is on world interest rates. Since the US is a large economy, an increase in domestic interest rates exerts upward pressure on the new equilibrium world interest rate. The model suggests that under an

expansionary fiscal policy without monetary accommodation, the new equilibrium is higher US output, higher interest rates, a higher trade deficit and stronger USD exchange rate.

The suggestion is that based on the outlook for fiscal and monetary policy, the US appears likely to recover faster than other countries that do not have its policy capacities. It also suggests that the trade deficit will widen, and the USD will depreciate.

Risk of geopolitical tension

Caldara and Iacoviello constructed a monthly index of geopolitical risk (GPR) by counting the occurrence of words related to geopolitical tensions in 11 international newspapers. The index is calculated by counting the number of articles related to geopolitical risks in each newspaper for each month as a share of the total number of news articles. The index is normalized to average 100 between 2000 and 2009.

With the new US administration, we expect the US will gradually return to traditional diplomacy. This also means the chance of a miscalculation between countries will diminish. There is more room to pursue cooperation in areas of common interest.

However, it should be clear that the underlying conflict between countries, from human rights to technology transfers, remains. Nonetheless, we also see common ground on issues like climate policy and trade, which should provide ongoing growth support for nations that continue to participate in globalization and open trade relations.

3. Macro and policy effects on rates and currency markets

As the M-F model suggests, higher fiscal spending and greater monetary accommodation will impact bond risk premiums, interest rates or the exchange rate. In the short run, interest rates are suppressed as the economy is still recovering, monetary policy continues to be accommodative, and demand for assets perceived as safe remains high. Inflation is currently not a concern due to the negative output gap, i.e., actual output is falling short of potential output. Therefore, the adjustment of the economy to the imbalances introduced by economic policies will fall on the exchange rate.

Europe

The economic recovery in the euro area is subjected to strong headwinds from the resurgence of coronavirus infections and reimposed restrictions. On the European Union (EU) level, a €100 billion job retention scheme was passed as well as the €750 billion Next Generation EU program, with the Recovery and Resilience Facility (RRF) of generous grants and loans to those countries hardest hit by the pandemic as its centerpiece.[10] These funds will provide fiscal support of about 1% of GDP per year on average between 2021–2024.[11] We believe the probability of an additional fiscal stimulus at the EU level, given that the payout of the RRF funds is scheduled to start in 2021, appears very low. Fiscal measures at the national level and the stretched fiscal capabilities in several countries leave much less space for additional programs to support the economies during and after the second wave of COVID-19. Fiscal policies in the euro area may therefore be less expansionary than in other parts of the world.

With the slow disbursement of the RRF and constraint on additional fiscal stimulus, we remain cautious in our euro area growth outlook. At the same time, the European Central Bank (ECB) has shown its willingness to support the recovery through asset purchases and credit creation (e.g., targeted longer-term refinancing operations [TLTRO]). The combination of a lower fiscal impulse and looser monetary policies should provide strong headwinds for the euro versus the USD.

Japan

Japanese consumers have been battered since the fourth quarter of 2019 when the consumption tax was raised. Before Japanese consumers could recover from the tax hike shock, COVID-19 arrived. Accordingly, Japanese GDP fell for three consecutive quarters before it rebounded in the third quarter of 2020. We have a constructive outlook for Japan's economy; however, the economic recovery is by no means likely to be stellar. Here are three factors behind our view that the Japanese economy is set to stay on a recovery path in 2021:

First, Japan, as a major exporter of capital goods, is expected to continue to benefit from a global recovery that is likely to expand from consumers to businesses as it matures.

Second, after the tax hike about a year ago, Japanese fiscal policy is currently expected to take a more activist approach, which was recently confirmed by the third supplementary budget that included about ¥22 trillion worth of public spending.

Third, we expect the Bank of Japan's (BoJ's) monetary policy to remain accommodative for an extended timeframe as the bank's 2% inflation target is not expected to be reached any time soon.

Given these observations, there are headwinds and tailwinds to the Japanese yen (JPY). While we are not expecting rate normalization any time soon in the US, the tendency of market rates to move in advance of Fed policy changes would likely become a headwind to the JPY even now. With the tail risk of the global health crisis almost behind us, global investors' demand for JPY as a perceived safe haven asset is likely to diminish substantially until we see another big "risk-off" situation. The flip side is that the Japanese economy may also stay on the recovery path for a long time, especially if the government doesn't face any funding issues in financing stimulus measures. While inflation in Japan is weak at this moment, the deflation mindset doesn't seem to be prevailing even after the three quarter-long recession. The JPY is currently as strong as its level at the COVID-19 peak in bilateral terms. However, it is also the case that the JPY is weaker than its peak in real effective terms, and real rate differentials with US interest rates are likely to benefit the JPY. The JPY is more likely than not to move in step with the currencies of Japan's trading partners. Finally, the JPY appears more likely to move directionally with other Asian currencies than not, as the region collectively outperforms the rest of the world.

China

The outperformance of Chinese growth last year has been extraordinary, supported by effective control of COVID-19, as well as the country's undisrupted role as the provider of global production and its ability to efficiently execute stimulus measures while preserving the stability of its financial system.

We think most of the factors listed above will still be in play for most of 2021, while China's export sector is expected to also benefit from a synchronized global recovery. China's relative restraint in macro policy during the pandemic also bodes well for its future. The size of its fiscal stimulus was much smaller compared to other key regions such as in the US, the euro area or Japan. Accordingly, the fiscal payback next year is expected to be milder than in Japan or the US. The People's Bank of China has also been conservative in adding monetary stimulus. As a result, China maintains relatively high nominal and positive real interest rates. This means that, while the country's fiscal deficit is by no means small, the economy doesn't need to be forced into a large negative fiscal impulse. Recent broader-based recoveries from production and exports to retail sales suggest that consumers are expected to increasingly become the more important driver of growth. The stability in asset markets along with the recent appreciation in the CNY should boost consumers' ability to consume. Also, although the pressure put on its technology sector from the US and its allies may bite in the near term, there is no question that those external pressures are likely to hasten the country's efforts to build its own technological capacity and to move up the value chain with less dependency on foreign technology. This new style of fiscal stimulus in the country's high tech infrastructure is likely to boost the country's private investment as well.

Going forward, it will be interesting to see China's economic strategy for the next five years and beyond. According to its recently announced five-year economic plan, the country's focus is dual circulation; that is, while the economy continues to rebalance and strengthen domestic demand, the economy also needs to keep a strong footing in the global market. We expect China to play an increasing role not only in global value added, but also as a global market for intermediate and final goods. We see stars aligned for a stronger CNY.

Asian Markets

We expect the global rollout of vaccinations to create significant investment opportunities in Asian emerging markets. These growing opportunities are on top of the sound economic fundamentals in many countries within the region. Six factors form our bullish view on Asian currencies:

First, the rest of Asia will benefit from the strong growth of China. Chinese growth is expected to be faster than that of its large counterparts around the world, and China's recovery has already had a head start.

Second, the growth outlook for Asian emerging markets is much stronger than that of the rest of the emerging world. That is on top of stronger growth in emerging economies than developed economies, a trend that appears likely to continue.[12]

Third, current accounts in Asian emerging markets are fundamentally stronger than those in the rest of the emerging market world, providing strength and stability for the region's external accounts. In a world where financial and external risks are elevated, a pivot to Asia is a comparatively sounder and more responsible approach, in our view.

Fourth, most countries in Asia are fiscally responsible, and the burden of fiscal adjustment is relatively light and manageable. Despite the pickup in public debt in 2020, with very few exceptions the level of public debt remains low, and below or about 60% of GDP. These conditions are beneficial for the region, as the fiscal adjustments should be less of a burden to the economic recovery in the post-pandemic world.

Fifth, the region keeps relatively high interest rates compared to other regions. There are no negative rates in the region, with the exception of Japan. While central banks have been proactive in supporting their economies since the pandemic, they have been prudent enough to keep rates positive. Many countries maintain decent levels of yield in the context of their fundamentals. Ten-year local-currency bond yields in Indonesia and India are around 6% at the time of this writing.

Sixth, the COVID-19 responses in Asia-Pacific countries were much better than in the rest of the world, led by East Asia, Australia and New Zealand. This is important because the negative growth impacts have been much milder in these regions than for the rest of the world, and also because the long-term scars from the pandemic are likely to be much more manageable. Accordingly, Asia is likely to head to a stronger and more sustainable recovery path.

Conclusion

Economic recoveries from the pandemic are ongoing but continue to be largely dependent on fiscal and monetary support, in our assessment. As we explored in Section 2, the economic policy choices of the US will continue to have significant implications for the rest of the world. Extraordinary fiscal and monetary policy should continue to support US growth while keeping interest rates at low levels. However, economic theory suggests that such a policy mix will lead to depreciation of the USD against currencies in economies that have managed the economic headwinds better and are in a structurally stronger condition (on domestic and external accounts). Specifically, Asia remains at the forefront of the global recovery on those merits, with several countries likely to benefit from proximity and close economic ties to China. Notably, while major developed markets such as the euro area and the US contend with deepening fiscal deficits and excessive monetary accommodation, several emerging markets in Asia are in stronger fiscal shape, with greater growth potential, robust trade dynamics and current account surpluses.

There continues to be significant variation in how countries have handled the pandemic, managed fiscal and monetary policy, and supported their economies. Poor handling of the health crisis has often led to greater social and structural disruptions. In the US, fiscal support to households was strong during the initial stages of the pandemic as fiscal package transfers were made via checks, as well as through expansions of UI programs and other federal programs. Though support waned through the end of 2020, ambitious new programs are in the works for 2021. We expect the US economy to continue to be supported by expansive fiscal policy and ample monetary accommodation in the upcoming year. This stance has important implications not only for the US economy, but also for countries around the world as they shape policy around the expectations for the persistence of a low-rate environment.

In Europe, fiscal measures at the national level and the stretched fiscal capabilities in several countries leave much less space for additional programs to support the economies during further adversity. Fiscal policies in the euro area may become more restricted than in other parts of the world. On the monetary front, low inflation and a lack of additional fiscal stimulus means the ECB will likely maintain extraordinary monetary accommodation. The combination of a lower fiscal impulse and looser monetary policies should provide strong headwinds for the euro versus the USD, in our assessment.

China's positive growth in 2020 was an impressive standout amid the massive contraction in economic activity around the world. Effective control of COVID-19 and the country's role as the provider of global production were key factors in its economic resilience in 2020. China also benefited from efficiently executing stimulus measures while preserving the stability of its financial system. Looking ahead, the CNY appears poised to strengthen against the USD given substantial growth differentials between the two countries. As the global economy recovers, we expect demand for Chinese goods to expand significantly. Fiscal capacity has also been better preserved in China than in other major economies. Additionally, recent external stability may encourage Chinese policymakers to allow the CNY to appreciate through market forces.

Strong growth in China should also benefit the rest of Asia, as China outpaces the major economies and already has a head start in its post-pandemic recovery. Many Asian countries also have healthier fundamentals and stronger growth outlooks than those of the rest of the emerging world. Countries in Asia have also shown better fiscal management in recent years, and benefit from robust trade dynamics and current account surpluses. We expect specific currencies in Asia to appreciate against a weaker euro and USD in the medium term, as the advanced world contends with excessive monetary accommodation and fiscal deficits that are unequalled since the post-war reconstruction era, while countries in Asia lead the way into the post-pandemic era on healthier fiscal balances, manageable debt burdens and stronger growth.

Endnotes

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Global Macro Shifts

Asia at the forefront: The world's uneven emergence from COVID-19

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