August 2020

Global Macro Views

The Global Macro Forum

BNY MELLON | INVESTMENT MANAGEMENT

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World

	2018	2019	2020	BoR	2021	BoR
Real GDP	3.2%	2.6%	-4.2%	–	5.2%	–
Inflation	2.9%	2.8%	2.0%	–	2.6%	–

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

Pandemics have been a recurring scourge over history, and now it is this generation's turn. For probably the first time, however, the world is wealthy enough to devote material resources to influence the path of a pandemic to conserve health care resources. Central to our economic forecast is an assumption about that path. Our base case is that nature runs its course. The pandemic runs an inverted "V-shape" in each country, with the upward leg of new cases sharper that the downward one.

Countries started the journey at different times, mostly determined by location. The asymmetry of the "V" depends on national attitudes, policies, and luck. The coronavirus does not respect national borders and is regressive in incidence, hitting poorer people and countries harder both in terms of infections and adverse results. Confirmed cases will be steeper and build for longer than that of fatalities as the world is getting better at preventing, detecting, and treating COVID-19. Aggregating these disparate curves to the global total pushes out its inflection point. We do believe it gets better, but that is related to partial herd immunity. The coronavirus will remain in the global gene pool.

Mitigation efforts—sheltering in place, quarantines, and border closings—have been disrupting economic activity. They keep people away from the marketplace and their jobs to the detriment of spending and production. The result has been a dramatic downturn in economic activity, more uneven than the pandemic itself given the nature of the mitigation efforts. People in poorer nations tend to work in the community (often outside the formal sector) and live hand to mouth, implying that sheltering in place is not an option. Moreover, they and their governments lack resources to buffer a severe adverse shock. As a result, we have cut the outlook for economic growth by more for emerging market than advanced economies. The exception is China and its near neighbors. China, with a considerable command-and-control element in its economy and a government efficient in tracking its citizens, dug a significant firebreak to slow the spread of the coronavirus. In the Mellon outlook, Chinese real GDP expands at 1 percent this year, dismal by the standard of the prior four decades but stellar in the community of nations. Near neighbors along the Pacific Rim reliant on China, with similar skills in contract tracing, are expected to top the league table of economic growth. Those emerging market economies dependent on other partners, commodity exports, and tourism will fare much more poorly in our view.

Advanced economies rely relatively more on services than physical trade, typically have a technological backbone that allows more production and consumption to be done remotely, and can tap into stored resources at the private and public level. Still, the shock is severe. Some shuttered businesses will not reopen. Having depleted their savings, their owners will view entrepreneurship less favorably in the future. Some of the workers that were laid off or fired will exit the labor force for good. Others will lose skills and miss development opportunities while unemployed. Those never employed—graduates entering the 2020 market—will find that a stumble at the starting gate impairs lifetime earnings prospects.

Cyclically, the official sector's response to adverse economic shocks has become more assertive over time. The fiscal expansion in advanced economies in response to the coronavirus pandemic has thus far been significantly larger than during the Global Financial Crisis. Governments in emerging market economies have also stepped up as well. According to the latest projections from the International Monetary Fund (IMF), governments in advanced and emerging market economies will be running budget deficits of 16½ percent and 10½ percent of their respective nominal GDPs in 2020. Both are impressive tallies, but more so for the latter that do not typically move strongly to counter the business cycle. To some extent, the deficits are the involuntary response to collapsing revenues and ballooning care expenditures. Part, too, owes to the extraordinary receptivity of investors to their debt issuance in an environment of compete monetary policy accommodation.

All major central banks have their policy rates at their effective lower bound and quickly embarked on expanded loan and asset-purchase programs. With inflation low, they seem intent on keeping policy accommodative until resource slack is worked down significantly. Because the current sudden and sharp economic contraction owed importantly to the shutdown of market activity to control the pandemic's path, lifting those lockdown orders is being associated with a dramatic rebound. Rebound is not recovery. The process of healing most likely will take some time, as economies tend to recover slowly and tend to have hesitant expansions after severe economic contractions as a result of the severe balance-sheet damage done during the process. We expect central banks to appreciate this and keep their policy rates at their effective lower bounds for at least two years and leave lending and asset purchase facilities open longer than strictly necessary to support market functioning. The secular combination of lower equilibrium real rates and lower inflation implies that the renormalization of policy rates, when it comes in the fullness of time, will be to a relatively low level as judged by history.

General Government Fiscal Balance and Gross Debt

2019-2021 (Percentage of GDP)

	Overall Fiscal Balance	Current Projections		Gross Debt	Current Projections	
	2019	2020	2021	2019	2020	2021
World	-3.9%	-13.9%	-8.2%	82.8%	101.5%	103.2%
Advanced Economies	-3.3%	-16.6%	-8.3%	105.2%	131.2%	132.3%
United States	-6.3%	-23.8%	-12.4%	108.7%	141.4%	146.1%
Euro Area	-0.6%	-11.7%	-5.3%	84.1%	105.1%	103.0%
Germany	1.5%	-10.7%	-3.1%	59.8%	77.2%	75.0%
France	-3.0%	-13.6%	-7.1%	98.1%	125.7%	123.8%
Italy	-1.6%	-12.7%	-7.0%	134.8%	166.1%	161.9%
Spain	-2.8%	-13.9%	-8.3%	95.5%	123.8%	124.1%
Japan	-3.3%	-14.7%	-6.1%	238.0%	268.0%	265.4%
United Kingdom	-2.1%	-12.7%	-6.7%	85.4%	101.6%	100.5%
Canada	-0.3%	-12.6%	-5.8%	88.6%	109.3%	108.8%
Australia	-3.9%	-8.6%	-8.4%	45.0%	56.8%	64.3%
South Korea	0.4%	-3.6%	-2.4%	42.9%	49.5%	53.4%
Emerging Market Economies	-4.9%	-10.6%	-8.5%	52.4%	63.1%	66.7%
China	-6.3%	-12.1%	-10.7%	52.0%	64.1%	70.7%
India	-7.9%	-12.1%	-9.4%	72.2%	84.0%	85.7%
Indonesia	-2.2%	-6.3%	5.0%	30.5%	37.7%	40.3%
Russia	1.9%	-5.5%	-3.9%	13.9%	18.5%	18.8%
Turkey	-5.3%	-8.4%	-7.5%	33.0%	40.4%	42.2%
Brazil	-6.0%	-16.0%	-5.9%	89.5%	102.3%	100.6%
Mexico	-2.3%	-6.0%	-4.0%	53.7%	65.9%	66.3%
Saudi Arabia	-4.5%	-11.4%	-5.6%	22.8%	35.2%	36.8%
South Africa	-6.3%	-14.8%	-11.0%	62.2%	79.9%	84.6%

Source: IMF staff estimates and projections.

Even so, interest expense will be an increasing drain on government resources. The large budget deficits of this year and next put the ratio of general government gross debt to GDP at 132 percent and 67 percent, respectively, for advanced and emerging market economies in 2021. The worrisome aspect of that lower number is that many emerging market economies lack the institutional frameworks to deal with large debt loads. Indeed, most emerging market sovereign defaults occurred at debt ratios below 60 percent, the old Maastricht requirement.

Developed Markets

United States

	2018	2019	2020	BoR	2021	BoR
Real GDP	2.9%	2.3%	-4.5%	–	3.5%	–
Inflation	2.3%	1.8%	1.0%	–	2.8%	–

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

The US economy is apparently following the upward-sloped portion of its V-shaped business cycle, having turned the corner in early May. In the time since, the insured unemployment rate has fallen 6 percentage points, about one-third the rise from March to May. Easing of lockdown restrictions and some rebound in household confidence are encouraging people to return to the marketplace in some states and localities, importantly supported by policy impetus. The US is a big country, however, and the experience is disparate. With the continuing COVID-19 caseload building and re-imposition of mitigation efforts in some places, the improvement in spending and output has flagged of late. Moreover, the level of activity remains well below that of the turn of this year. Rebound is not recovery. The hole dug into the US economy by the pandemic is deep and climbing out will take about two years.

Supply-chain disruptions have pushed up the prices of some goods, importantly including food, but the weight of deficient demand has pulled overall inflation well below the Federal Reserve's 2 percent goal. As a result, we expect monetary accommodation to remain full throttle until inflation ultimately reverts to goal. This transition will be lengthy but should be sped along by a weaker US dollar, whose exchange value continues to depreciate as the US loses some of its relative luster as the provider of safe-haven assets.

Other advanced economies are mostly following this basic track, with twists and turns related to the dynamics of the pandemic.

Western Europe

Euro Area

	2018	2019	2020	BoR	2021	BoR
Real GDP	1.8%	1.1%	-9.0%	⮟	8.0%	⮟
Inflation	1.8%	1.2%	0.4%	–	0.9%	–

United Kingdom

	2018	2019	2020	BoR	2021	BoR
Real GDP	1.3%	1.2%	-10.0%	⮟	7.0%	⮟
Inflation	2.7%	1.9%	0.8%	–	1.3%	–

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

The outbreak of the COVID-19 pandemic in Western Europe and the extraordinary lockdown measures that began in March 2020 saw economic activity collapse in a fashion unprecedented during peacetime. The severity of these measures began to ease in May, although the pace was varied across jurisdictions for a variety of reasons. While economic activity is resuming as certain sectors of the economy reopen (as shown by the sharp bounce-back in leading indicators in May versus April), we believe there will be a prolonged period of social distancing and other containment measures—thus a "new" normal will maintain until a vaccine or other solution is available. The "new normal" will impinge on economic activity in different ways in different countries. While manufacturing may return in Germany, the service-dependent economies of southern Europe will likely see a prolonged recession. Tourism in particular seems to be lost for 2020.

The European Central Bank (ECB) has been providing monetary stimulus since the onset of the COVID-19 outbreak and recently expanded its Pandemic Emergency Purchase Program (by greater magnitude and duration than expected). In addition, the ECB maintains dovish guidance regarding potential increases in quantitative easing (QE) as well as providing additional and very inexpensive liquidity operations for banks (both lending and non-lending contingents). However, the ECB has opted not to cut interest rates, viewing this as relatively ineffective. On the fiscal side, there has been significant progress towards a multi-state stimulus in the form of the Recovery Fund. While there are many competing versions of the Recovery Fund being offered, we expect the stimulus to look similar to that proposed by Angela Merkel and Emmanuel Macron.

In the UK, the lifting of restrictions and progress towards a new normal has moved slightly quicker than expected. However, the government provided additional fiscal stimulus by extending its furlough scheme until October and introducing a further stimulus package in July. Government borrowing in fiscal year 2020/2021 was already set to be the highest on record during peacetime, and is likely to grow further as the government supports the economy. The Bank of England (BoE) expand its QE program by another £100 billion in June. However, it seems unlikely that the BoE will engage in negative rates unless economic activity significantly deteriorates in the fourth quarter of 2020. Brexit talks will continue throughout 2020, and our base case remains an extension to the transition period although we note the slightly increased risk of a no-deal exit.

Japan

	2018	2019	2020	BoR	2021	BoR
Real GDP	0.3%	0.8%	-5.0%	⮟	2.0%	–
Inflation	1.2%	0.8%	-0.2%	⮟	0.0%	⮟

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

Japan's starting point for 2020 was weak after being hit with the triple whammy of Typhoon Hagibis, the VAT tax hike, and the China-US trade war. As a result of these forces, annualized growth contracted 7.1 percent in the fourth quarter of 2019. In the first quarter of 2020, real GDP fell another 0.9 percent quarter-over-quarter (QoQ) and 3.4 percent annualized because of the pandemic, officially bringing Japan into a technical recession. We expect Japan's economy to contract by 5 percent in 2020. While the state of emergency was lifted on May 25th, the resumption of economic activity will remain gradual as people adjust to a new normal. Tourism and external demand will take a while to recover.

The Bank of Japan (BoJ) has left its policy rate and yield-curve-control targets unchanged. However, the JPY 80 trillion upper limit on bond purchases has been removed—mostly a symbolic move in our view as the BoJ's pace of purchases was not anywhere near that threshold. The BoJ introduced a new fund-provisioning measure on May 22nd designed to coordinate with the government's emergency support for the economy. The Japanese yen has been relatively well behaved and has not appreciated to the degree that some had expected. This represents a lower risk from excessive safe-haven currency appreciation.

Core inflation risks are falling into deflationary territory, prompting further accommodation from the Bank of Japan though it is running out of policy tools. We forecast slight deflation of -0.2 percent year over year (YoY) in 2020, and then flat in 2021. In our view, the BoJ will not hit its 2 percent price target at any point during our forecast horizon.

Australia & New Zealand

Australia

	2018	2019	2020	BoR	2021	BoR
Real GDP	2.8%	1.6%	-4.2%	⮟	2.0%	⮟
Inflation	2.0%	1.5%	0.4%	-	1.1%	-

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

In light of COVID-19's impact on the Australian and global economy, Australia has rapidly deployed record levels of fiscal and monetary-policy accommodation. Lockdowns shuttered many parts of the economy beginning in April, especially the tourism and travel sectors. Data showed the Australian economy contracted -0.3 percent QoQ in the first quarter. This is a small negative given the major events of bushfires and beginning of the pandemic. The second quarter faces a much larger drop as lockdowns take full effect. We expect a rebound to take hold from the third quarter with a bottoming in late May. The 2020 growth slowdown will be sharp, but not as deep as previously anticipated. The economic recovery, however, will be longer and slower as borders are likely to remain closed for many months and population growth has slowed.

Public health measures have proved effective, with the COVID-19 outbreak largely under control and parts of the economy beginning to reopen. During this period of "hibernation", government spending and the JobKeeper program have subsidized wages and propped up aggregate demand, keeping as many Australians attached to the labor force as possible.

We expect that public borrowing will expand significantly, rapidly growing the size of Australia's debt market. The Reserve Bank of Australia (RBA) lowered its policy rate to the effective lower bound of 0.25 percent, implemented a 0.25 percent yield target for Australian government securities out to 3-year maturities, and shored up liquidity. As markets have stabilized in recent weeks, the RBA has "tapered" its secondary market purchases to around zero. However, the central bank remains ready to step into the market at any time to clear dislocations and increase accommodation if required. The post-COVID Australian economy is so far tracking along one of the RBA's more upbeat scenarios. In the event of disappointment, the RBA has several options such as extending yield targets further out the curve. Negative rates appear to be off the table for the time being.

Likewise in New Zealand, early and effective lockdowns mean there is only one remaining active case of COVID-19 at the time of writing. Massive fiscal and monetary stimulus has been delivered. New Zealand's relatively small government debt market will more than double in order to meet budgetary funding needs. The Reserve Bank of New Zealand (RBNZ) has been extremely active in the secondary market by purchasing securities and flattening the yield curve. The RBNZ will buy up to NZD 60 billion of New Zealand government bonds, but we think the ceiling will be increased to NZD 90 billion in coming months. The prospect of negative rates has been more openly discussed in New Zealand than in Australia but is not likely to be implemented until 2021 in our view.

Emerging Markets

China

	2018	2019	2020	BoR	2021	BoR
Real GDP	6.6%	6.1%	1.5%	⮟	7.5%	⮟
Inflation	2.5%	2.9%	2.3%	–	1.9%	–

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

Activity has begun rebounding following the end of COVID-19 lockdowns and rollout of credit easing and fiscal policy stimulus. The People's Bank of China's (PBOC) focus on re-lending and credit easing alongside higher local government spending has begun boosting property and infrastructure and shoring up production. These are starting to revive production and domestic demand. This is evident from the pick-up in both manufacturing and services purchasing manager indexes (PMIs) to above 50. Export subcomponents of the PMIs, however, remain weak—signaling headwinds to a full recovery.

Even with the ongoing domestic demand rebound, output losses in the earlier months of year, the slightly slower recovery of the services activity, and the ongoing slump in external demand will keep full-year GDP growth restrained to around 1½ percent YoY. These trends emerge from sizable negative output gaps and subdued inflation in the near term, a moderating current account surplus despite a sharp reduction in outward tourism flows from the country, and lower oil prices.

In this context, the recently concluded National People's Congress (NPC) confirmed the rollout of expansionary policies at the central government level. We now expect an increase in the general government fiscal deficit, by 5 percent of GDP, to deliver a sizable fiscal impulse as well. Following the NPC meetings, the PBOC has been uncharacteristically slow in its accommodation of the government's stimulus program. We think this reflects the central bank's caution about a revival of speculative activity rather than an unexpected tightening in policy. As such, we continue to anticipate gradual easing of around 150 basis points of the banks' reserve requirements in the next six-to-nine months and another 30-40 basis points of cuts in the medium-term lending facility, through which the central bank will inject additional funds. The PBOC may also purchase some portion of the central government's special bonds.

A bit further out, however, we believe the macro outlook for China is unusually uncertain. This is on account of its widening geopolitical rift with the U.S., which now encompasses not only trade but also technology transfers, Chinese firms' equity listings in the U.S., and the status of Hong Kong. An abrupt imposition of further trade tariffs or a sharp ratcheting up of controls on technology transfers could weigh on China's net exports and delay the scheduled 5G rollout across the country in 2021. A revocation of Hong Kong's international status by the U.S. administration coupled with sanctions and large-scale de-listings of Chinese firms on American equity exchanges could weigh on capital raising in Hong Kong by Chinese tech firms and state-owned enterprises. It could even crimp funding for Belt and Road projects. These risks, should they materialize, will also hurt the viability of the Hong Kong dollar peg and the profitability of western banks, who have come to rely on Hong Kong as gateway to China or as a hub for their Asia operations.

Our base-case assessment of the country's bilateral relationship with the U.S. is for an "antagonistic muddle-through" until U.S. elections are completed, with both sides remaining rhetorically committed to the phase one trade deal. In our view, the main risk is worsening tensions that threaten to undermine the fragile balance and complicate any realistic prospect of reaching a workable agreement on "phase-two" issues ---centered on technology, intellectual property, market access and industrial policy. The ensuing uncertainty, and any near-term flare-ups, could persistently raise risk premiums on the CNH (and the Hong Kong Dollar.).

South Korea

	2018	2019	2020	BoR	2021	BoR
Real GDP	2.7%	1.9%	-1.0%	–	4.0%	⮟
Inflation	1.7%	0.5%	0.0%	⮟	1.2%	–

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

The Korean economy has managed to contain the COVID-19 outbreak better than many other developed countries despite sporadic, renewed outbreaks in a few parts of the country. The better health response coupled with shallower lockdowns and a sizable stimulus package should contain the depth of the full-year economic contraction to around 1 percent of GDP. The Bank of Korea (BoK) has cut the policy rate by 75 basis points this year to a historical low of 50 basis points. The government announced a stimulus package amounting to around 4 percent of GDP and a full-year fiscal deficit of nearly 6 percent of GDP. Fiscal easing should be helped by the recent National Assembly elections, at which the ruling party managed to secure an absolute majority, raising the bar for political obstructionism. While domestic demand should improve lockdowns ease, Korea is a highly open economy and growth could be held back by weak external demand. As the BoK reaches its effective lower bound, it has begun purchasing government bonds but with no pre-set targets or forward guidance (as yet). The BoK also broadened its collateral window and is enhancing its re-lending facilities. As external demand conditions normalize, we expect a bounce-back in GDP growth, in 2021, to 4 percent (YoY).

India

	2018	2019	2020	BoR	2021	BoR
Real GDP	7.4%	5.1%	-2.0%	–	7.6%	–
Inflation	4.2%	3.3%	3.0%	⮟	4.0%	⮟

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

India enforced a near total lockdown in March-April which brought economic activity to a grinding halt. But the country has failed to stem the rising tide of COVID-19 infections on account of inadequate testing capacity, relatively poor healthcare facilities, and large-scale internal migration of unemployed workers to their rural homes. The death rate has remained low, but continuing infections raise the odds of a prolonged struggle to "flatten the curve." We now think India will experience an outright economic contraction this year, even as several parts of the country ease the scale of the lockdowns. Growth should bounce back next year as domestic and external demand conditions normalize. But with its moribund banking system (saddled with non-performing assets and weak corporate balance sheets) and constrained fiscal policy space, even the modest incremental fiscal easing deployed this year will raise government debt to over 80 percent of the country's GDP (from around 70 percent, pre COVID-19). These trends highlight economic rigidities which persisted prior to COVID-19, and prompted Moody's to lower India's sovereign rating one notch to Baa3 and maintain a negative rating outlook. India's sovereign rating sits at the lowest of the investment grade scale, and we think further negative outlooks from the other two agencies could follow, which raises the risk of hardening term premiums.

Latin America

Brazil

	2018	2019	2020	BoR	2021	BoR
Real GDP	1.3%	1.0%	-6.0%	⮟	3.5%	⮟
Inflation	3.7%	3.7%	2.6%	⮟	3.0%	–

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

The Brazilian economy fell 1.5 percent QoQ, a deeper contraction than initially expected. The implementation of social distancing measures in mid-March had a significant effect on household consumption, which dropped 2 percent QoQ. The positive news came from investment that printed an expansion of 3.1 percent with respect to the previous quarter. The GDP breakdown by sector shows that the main detractor was services with a 1.6 percent contraction and industrial production with -1.4 percent, both on a QoQ basis.

Brazil has completed a fiscal stimulus close to 10 percent of GDP that we expect to mitigate the negative impact of COVID-19 shock in the second quarter and to contribute to boost economic activity after the shock. In May, we revised down our GDP growth forecast to -5.4 percent YoY contraction from -3.3 percent on the back of larger contraction of activity in March and April and the extension of social distancing measures at least until the end of June. We are projecting a gradual rebound of economic activity in 2021 to 3.5 percent, up from our previous projection of 2.9 percent in April.

External accounts in Brazil have deteriorated since 2017. A mix of wider current account deficit and more recently large portfolio outflows led the central bank to sell USD 46 billion in late 2019 and early 2020. The current account deficit reached -2.7 percent of GDP from -0.7 percent in 2017 on the back of a narrowing trade balance surplus and increasing net primary receipts. The trade balance surplus has stabilized at USD 44 billion (2.5 percent of GDP) in the second quarter of 2020 due to a contraction in the import of goods. We expect the current account deficit to shrink to 1.5 percent of GDP at the end of the year due to weaker domestic demand, commodity prices rebound (iron ore) and global trade improvement. We also expect capital outflows to stabilize gradually during the rest of the year. This will likely reduce further reduction of international reserves.

Brazil's Achilles' heel is its fiscal position that will likely suffer a sharp deterioration in 2020. We expect Brazil's primary balance to reach 9 percent of GDP and the debt-to-GDP ratio may increase to 90 percent at the end of 2020 from 76 percent in 2019. The government has postponed fiscal reforms due to the COVID-19 pandemic, and there is high uncertainty on the path of reforms after this shock due to political tension between the Executive and the Congress. The structural reforms that Brazil needs to stabilize its debt burden could be derailed due to the political turmoil, and the fiscal anchors, such as spending cap and the golden rule, could be at risk without those reforms.

After inflation peaked in the fourth quarter of 2019, it has fallen fast due to a significant slack in the economy and lower food prices. Spare capacity should push inflation temporarily below 2 percent in the second quarter of 2020. We lowered our average inflation projection for 2020 to 2.6 percent from 2.9 percent, below the central bank's target of 4 percent. The disinflationary effect of the negative output gap is very likely to dominate inflationary pressures coming from currency depreciation. The Central Bank of Brazil cut the Selic policy rate by 75 basis points to 3 percent in May and followed with another cut of the same magnitude to 2.25 percent in June.

Mexico

	2018	2019	2020	BoR	2021	BoR
Real GDP	2.0%	-0.1%	-9.0%	⮟	2.5%	⮟
Inflation	4.9%	3.6%	3.2%	⮟	3.6%	⮟

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

The Mexican economy dropped 1.2 percent QoQ in the first quarter of 2020. Economic activity has contracted sequentially since the first quarter of 2019. This means the economy was in a downward trend before the COVID-19 pandemic. On a year-over-year basis, GDP fell 1.4 percent, driven by industrial production (-2.9 percent) and services (0.7 percent). We expect a sharp contraction in the second quarter where the main detractors will remain services and industrial sectors.

We cut our 2020 GDP growth forecast to -7.9 percent from 6.2 percent as we expect a deeper contraction in the second quarter and a slow recovery after that due to a small fiscal stimulus, rapid job destruction and a large erosion of the tax base. Also, the recession in the US economy is taking a toll on manufacturing exports. Leading indicators such as auto exports dropped more than 90 percent YoY during the April-May period. Reduced foreign and domestic travel is pushing hotels and restaurant services to a sharp contraction. Wage remittances are up 12 percent YoY in the first four months of the year. However, we expect a 10 percent YoY contraction for the whole year. Lower oil prices have affected government oil revenues and it has increased the need of financial support to Pemex.

We expect a slow recovery of the Mexican economy in 2021 with a 2.5 percent expansion as private investment will remain depressed, household consumption will likely recover at a slow pace due to the large job destruction. Government austerity policy will limit any fiscal impulse.

We beleive the external sector will provide some support to economic growth due to the recovery in global demand, but relatively high real rates in Mexico will limit a weaker real exchange rate to boost non-oil exports. We expect a current account deficit of 0.1 percent of GDP in 2020, marginally down from the 0.2 percent in 2019. In the first quarter of 2020, the current account deficit was 0.4 percent of GDP and the financial account surplus fell to 0.8 percent of GDP from 1.4 percent in the previous quarter due to lower portfolio inflows. Foreign participation in the government debt market has been reduced to 24 percent in May 2020 from 38 percent at the peak in 2015. In the case of fixed rate nominal bonds, the reduction has been to 52 percent from 66 percent at the peak in 2017.

Although the fiscal stimulus is less than 2 percent of GDP, the primary balance will likely deteriorate to -3 percent of GDP from a primary surplus of 1 percent in 2019 due to a contraction in oil and non-oil revenues. The overall deficit will likely jump to 6 percent of GDP from 2 percent a year ago. The debt-to-GDP ratio may jump to 56 percent of GDP from 45 percent in 2019.

Inflation has been volatile in 2020 due to the interaction of different shocks. Inflation accelerated in the first two months of 2020 as food prices rebounded. Then it dropped in March and April due to lower fuel prices and more recently, inflation has rebounded due to shortages coming after the government implemented social distancing measures. We expect average inflation in 2020 to drop to 3.2 percent from 3.6 percent in 2019 due to economic contraction. The Central Bank of Mexico cut interest rates by 25 basis points in February to 7 percent and 50 basis points in emergency meeting in March to 6.5 percent. We expect the central bank to keep a pace of 50 basis point rate cuts in each of the next two meetings to reach 4.5 percent. Banxico will likely stop at that level due to increasing uncertainty on the inflation outlook.

Russia, Turkey, South Africa, CEEMEA

Russia

	2018	2019	2020	BoR	2021	BoR
Real GDP	1.7%	1.2%	-5.0%	⮟	3.5%	⮟
Inflation	3.5%	4.2%	4.5%	–	3.5%	–

Turkey

	2018	2019	2020	BoR	2021	BoR
Real GDP	3.0%	0.5%	-5.0%	⮟	5.0%	⮟
Inflation	17.0%	15.0%	13.0%	–	11.0%	–

South Africa

	2018	2019	2020	BoR	2021	BoR
Real GDP	1.0%	0.4%	-6.0%	⮟	2.0%	⮟
Inflation	4.7%	4.1%	4.5%	–	3.5%	–

Poland

	2018	2019	2020	BoR	2021	BoR
Real GDP	4.5%	4.2%	-4.0%	⮟	4.0%	⮟
Inflation	1.8%	2.2%	1.5%	–	2.0%	–

Source: Firm analysis as of July 6, 2020. 2020 and 2021 are forecasts. BoR (Balance of Risks): Indicates bias relative to our forecasts as new information becomes available. "⮟" represents a negative view and "—" indicates a neutral view.

Most jurisdictions in Emerging EMEA engaged in strict lockdowns early in the COVID-19 pandemic, and the data suggest they were rewarded with relative success in combating the health emergency. The data should however be treated with scepticism as shown by the experience of Russia, which is likely to be one of the worst affected countries in Emerging EMEA. However, the economic impact of such lockdowns have been severe, with most set to experience their sharpest contractions in activity during peacetime. Despite this, we do expect certain pockets of the region—such as CEE—to bounce back more quickly than their developed peers. High-yielding countries such as Russia and South Africa will likely experience slower recoveries.

Contractions in economic activity have prompted both fiscal and monetary stimulus. Monetary stimulus has occurred in multiple rounds in some countries, with rates cut close to the zero lower bound or to negative real rates, and QE programs launched. QE programs are for the most part designed to safeguard financial stability by ensuring the monetary transmission cycle is working (e.g. South Africa and Romania), although is being used to finance government deficits in other countries (e.g. Poland).

The Global Macro Forum

Vincent Reinhart
Managing Director, Chief Economist & Macro Strategist

Vincent is Mellon's Chief Economist and Macro Strategist. In this role, he is responsible for developing views on the global economy and making relative value recommendations across global bond markets, currencies and sectors.

Previously, Vincent served as the Chief US Economist and a managing director at Morgan Stanley. For the prior four years, he was a resident scholar at the American Enterprise Institute (AEI). Vincent also worked in several roles at the Federal Reserve over 24 years, including Director of the Division of Monetary Affairs and Secretary and Economist of the Federal Open Market Committee (FOMC). His responsibilities at the Federal Reserve included directing research and analysis of monetary policy strategies and the conduct of policy through open market operations, discount window lending and reserve requirements. Prior to these roles, he was the principal liaison with the domestic desk at the Federal Reserve Bank of New York and was responsible for preparing a document outlining policy alternatives for each FOMC meeting. He was Deputy Director in the Division of International Finance and Associate Economist of the FOMC and spent five years at the Federal Reserve Bank of New York in both the domestic and international research departments.

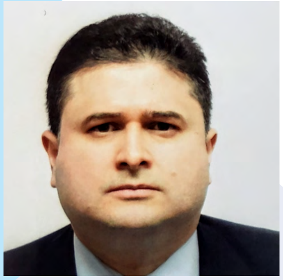
His academic publications primarily concern the conduct of policy and issues related to the monetary transmission mechanism as well as an analysis of alternative auction techniques and Treasury debt management. After an undergraduate training at Fordham University, he received graduate degrees in economics at Columbia University.

Rowena Geraghty
Sovereign Analyst

Rowena is a sovereign analyst at Mellon Investments (UK) Limited, an affiliated entity, and an associated person of the firm.

Rowena contributes to the bond and currency strategy for the Global and Emerging Market portfolios through her fundamental credit and market analysis. She is responsible for research and analysis of economies across EMEA. Rowena joined the firm in 2013. Previously, she worked at Fitch ratings agency and the financial regulator, the Financial Services Authority (a predecessor organization to the UK's current regulator, the Financial Conduct Authority).

Rowena has a BSc and MSc in Economics from the University of London. Rowena has been in the investment industry since 2010.

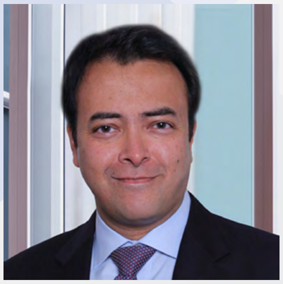


Alejandro Martinez Cruz
Emerging Market Economist

Alejandro is an emerging market economist with a particular focus on Latin American countries. He provides macro views, insights and trade recommendations based on his analysis of economic, statistical and socioeconomic data, which inform the investment decisions of the Emerging Market Debt team.

Prior to joining the firm, Alejandro held several senior roles at HSBC, including a Mexico rates and foreign exchange analyst, senior LatAm strategist and the Head of Latin American Fixed Income Research. In the latter role he led fixed income research efforts for Argentina, Brazil, Chile, Colombia, Mexico, Peru, Ecuador, Dominican Republic and Costa Rica. Previously, he was an economist for Citigroup, and a currency and local rates market analyst at the Bank of Mexico. Alejandro has been in the investment industry since 1998.

Alejandro earned a degree in economics from Instituto Tecnológico y de Estudios Superiores de Monterrey and a masters in economics from the University of Rochester.



Aninda Sankar Mitra
Vice President, Senior Sovereign Analyst

Aninda is senior sovereign analyst of BNY Mellon Investment Management Singapore Pte. Ltd and provides non-discretionary research or discretionary investment management services to the firm as a subadvisor. He is responsible for Asia ex-Japan sovereign debt research. Aninda joined in March 2014 from Fitch Ratings Credit Wire Service where he served as senior director Asia Pacific. Aninda was previously Head of Southeast Asia Economics at ANZ Bank and Senior Sovereign Analyst at Moody's in Singapore and New York.

Aninda holds a MA Economics from University of North Carolina and a BS Economics (Magna Cum Laude) from Bridgewater College. Aninda has over 22 years of experience as a sovereign analyst and economist focused on Asia.

Nicholas Tocchio
Sovereign Analyst

Nick is a sovereign analyst contributing to interest rate and currency strategy for global portfolios. He is responsible for fundamental credit and market analysis for Australia, Canada and New Zealand. Nick joined the firm in 2013 and holds a BA in Economics from Hamilton College. He has been in the investment industry since 2013.

Disclosure

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