

2021 Outlook: From Pandemic to Pandemonium?

A Publication of BMO Capital Markets Economic Research · Douglas Porter, CFA, Chief Economist, BMO Financial Group

Sometimes the stars align, and everything just goes right—then there is 2020. After a year in which very little went right, perhaps it's encouraging that Jupiter and Saturn are moving into alignment next week. Apparently, the conjunction between the two planets on Monday—which is also the Winter Solstice—will be the closest in almost 800 years. But that's not a key plank in our above-consensus call for the global and Canadian economy in 2021. We believe that there are many, more compelling, signposts that activity is coiling for a powerful rebound in the coming year after an incredibly challenging spell.

The **global economy is expected to rebound 5.5% in 2021**, and then advance another 4.0% in 2022, after plunging 4.0% this year. To put those figures into some perspective, the prior worst recorded year in the post-war era had been a drop of 'just' 0.1% in 2009, while a typical year for the world economy in recent times would see growth something just a bit above 3%. A keen observer would note that even with our call of a strong rebound in the coming two years that the level of activity would still be well below its underlying trend by the end of 2022. Part of that shortfall reflects the simple fact that some of this year's loss on spending in the service sector—such as on travel, entertainment, restaurants—may never be recouped.

The other part of the shortfall, though, may also suggest that even our relatively upbeat view on the next two years is **actually understating the potential for growth to snap back**. Insofar as vaccines are rolled out effectively, and there is a strong take-up, there is a case to be made that we are underestimating growth in the second half of next year and into 2022. Incredibly supportive fiscal and monetary policies, robust financial conditions (i.e., lofty asset prices), heavy-duty pent-up demand, and the build-up of excess household savings in many economies point to the possibility of a serious burst in spending later next year.

China serves as a clear example of how forcefully things can bounce back as conditions return to something approaching normality. Both retail sales and industrial production have carved out nearly a perfect V-shaped recovery in the world's second largest economy. Famously, it will thus be one of the few nations to post any growth this year; some of the other lucky few will include Taiwan, Vietnam and Ireland. We look for China to build on this year's constrained 2% rise with a robust 8% surge in 2021, before easing back to a more trend-like 5% in the following year. The three-year average growth rate of about 5% will pale only somewhat compared with the pre-virus trend of just over 6%. The sturdy rebound is a major reason why non-oil commodity prices—particularly base metals—have seen such a remarkably fast recovery even amid the deepest global downturn in decades.

One implication of the relatively robust recovery in commodity prices, as well as the deep dive in interest rates and strong financial markets, is that **emerging markets held up relatively well overall**. Despite a vicious drop in global GDP and the wild

ECONOMIC RESEARCH
economics.bmo.com

Douglas Porter, CFA, Chief Economist
douglas.porter@bmo.com

financial market turmoil in the spring, most emerging market economies avoided the worst. While there were some very specific cases of financial strains—Turkey—most were able to slash borrowing rates, capital flows resumed after a brief stall, and currencies began to recover as the U.S. dollar faded through the second half of the year. This is not to minimize the severe challenges many emerging economies face, especially those heavily reliant on tourism. But, the resiliency of the developing world and a crisis averted on this front is a case of the dog that didn't bark.

In the **advanced economies**, sectors that were able to re-open did see a rapid V-shaped recovery in Q3 from the spring shutdowns, and that provides comfort for the call for strong gains in 2021. However, large portions of the economy have still been left behind, and the furious second wave has seen broadening and deepening restrictions across much of the OECD more recently. Amid the patchwork of varying and constantly changing measures, it's incredibly difficult to assess the economic damage from the second-wave containment steps. It appears that financial markets are all but ignoring the mounting bad news and focusing on the post-vaccine world. But that doesn't get around the fact that we are about to face a wave of tough economic statistics in coming weeks, most likely including an outright drop in European GDP in Q4, and a near-miss in other economies.

The **Euro Area and the U.K.** are going to report some of the biggest economic declines in the world for 2020, owing to both their especially challenging experience with the virus but also due to a heavy reliance on the service sector (notably tourism). The flip-side is that these economies may also be poised for the biggest snapbacks. After a near-7% drop in the Euro Area, we look for a 5.5% rebound in the coming year, and then a 3% advance in 2022. The U.K. was hit even harder with a massive 11% setback this year, with Brexit uncertainty weighing on top of everything else. With just days to go, the prospects for a trade deal with the EU are fading, but a partial recovery is still likely in 2021 even in a no-deal world. (On a technical note, the dive in U.K. GDP appears to be exaggerated by an unusually large reported drop in government spending, which may also set the stage for an unusually big rebound in 2021.)

Elsewhere, **Japan** saw a somewhat lighter hit than other major developed economies with a drop of just over 5% this year—everything is relative—even though it entered the year already in recession after last year's sales tax hike. Given that nation's weak underlying growth and a milder setback in 2020, we expect a more modest 3.5% recovery next year, even with the delayed Tokyo Olympics. **Australia** also was relatively less hard-hit, despite the massive wildfires at the start of the year, a one-sided trade fight with China, and a strong lockdown in Victoria. While the RBA is trying to hold it back, the Australian dollar is now up more than 10% from a year ago and not far from parity with the loonie at around 76 cents(US).

When the final numbers are in for 2020, one truly unusual development (among the many) is that the **U.S. economy** is likely to print one of the smallest declines in the advanced world. We have chopped this wood before, but the short story is that the U.S. benefited from some of the strongest policy medicine in the world as well as its outsized tech sector. However, we also have to point out that restrictions were relatively light in the U.S. compared to others—even now, with some of the highest virus caseloads in the world on a per capita basis—and thus the direct economic hit

was lighter. As the year draws to a close, markets are almost fully anticipating that a new round of fiscal support of \$900 billion (or a hefty 4% of GDP) is nigh, including direct payments of \$600 per individual. If enacted in a timely fashion, this could add to our upgraded call of 4.5% GDP growth for next year; we have also bumped up our 2022 call by half a point to 3.5%. Yes, one could say that the vaccine has moved the needle on growth, pardon the awful pun.

We have also tweaked our call on **Canadian growth** over the next two years. However, unlike the U.S., this revision is not one-sided to the high side. Full disclosure, we have been relentlessly on the high side of consensus for more than six months now, and remain there even with these revisions. Still, the deepening restriction measures in Canada, with the clear prospect of more in coming weeks—including new school closures in some provinces—have prompted us to trim our Q1 call to close to zero. Even with a stronger second-half rebound, courtesy of the vaccine (first injection just this week in Canada as well), this will clip the full-year estimate for GDP growth by half a point to 5.0%. But, at the same time, we are also lifting the view on 2022 on the upbeat vaccine developments by half a point to a sturdy 4.5%, leaving activity at the same spot as we had expected before by the end of that year. While we have trimmed our 2021 call, note that the risks appear evenly balanced; that is, there is still some serious upside risk to this forecast, and the recent strength in commodity prices, and financial markets in general, are certainly pointing in that direction.

Beyond the growth outlook, of course there are many, many other economic issues and concerns swirling in this tumultuous environment, which are mostly covered in this week's Focus publication. But one pressing question we have fielded almost since the first days of the pandemic response is whether there is a **risk that inflation could return** amid the tidal wave of stimulus. These concerns may well grow louder in the coming year, especially if growth comes close to the upside possibilities. And the Fed has essentially told us that they will tolerate a bout of above-target inflation. As if on cue, Canada printed a high-side surprise for CPI of 1.0% y/y in November, and the spurt in oil to \$49 points to further headline pressure. But also note that Japan, China and the Euro Area are all still posting outright declines in headline prices, while core inflation is effectively stuck in neutral in North America. Ultimately, while the tail risks for inflation have fattened, we believe that even in a world of a potentially rapid recovery, overwhelming slack in many sectors, and an overhang of unemployment for years, any burst in headline inflation will simply not be sustained.

General Disclosures

"BMO Capital Markets" is a trade name used by the BMO Investment Banking Group, which includes the wholesale arm of Bank of Montreal and its subsidiaries BMO Nesbitt Burns Inc., BMO Capital Markets Limited in the U.K., Bank of Montreal Europe Plc in Ireland and BMO Capital Markets Corp. in the U.S. BMO Nesbitt Burns Inc., BMO Capital Markets Limited, Bank of Montreal Europe Plc and BMO Capital Markets Corp are affiliates. BMO does not represent that this document may be lawfully distributed, or that any financial products may be lawfully offered or dealt with, in compliance with any regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder. This document is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Their contents have not been reviewed by any regulatory authority. Bank of Montreal or its subsidiaries ("BMO Financial Group") has lending arrangements with, or provide other remunerated services to, many issuers covered by BMO Capital Markets. The opinions, estimates and projections contained in this report are those of BMO Capital Markets as of the date of this report and are subject to change without notice. BMO Capital Markets endeavours to ensure that the contents have been compiled or derived from sources that we believe are reliable and contain information and opinions that are accurate and complete. However, BMO Capital Markets makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors and omissions contained herein and accepts no liability whatsoever for any loss arising from any use of, or reliance on, this report or its contents. Information may be available to BMO Capital Markets or its affiliates that is not reflected in this report. The information in this report is not intended to be used as the primary basis of investment decisions, and because of individual client objectives, should not be construed as advice designed to meet the particular investment needs of any investor. This document is not to be construed as an offer to sell, a solicitation for or an offer to buy, any products or services referenced herein (including, without limitation, any commodities, securities or other financial instruments), nor shall such information be considered as investment advice or as a recommendation to enter into any transaction. Each investor should consider obtaining independent advice before making any financial decisions. This document is provided for general information only and does not take into account any investor's particular needs, financial status or investment objectives. BMO Capital Markets or its affiliates will buy from or sell to customers the securities of issuers mentioned in this report on a principal basis. BMO Capital Markets or its affiliates, officers, directors or employees have a long or short position in many of the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. The reader should assume that BMO Capital Markets or its affiliates may have a conflict of interest and should not rely solely on this report in evaluating whether or not to buy or sell securities of issuers discussed herein.

Dissemination of Economic Publications

Our publications are disseminated via email and may also be available via our web site <https://economics.bmo.com>. Please contact your BMO Financial Group Representative for more information.

Additional Matters

This report is directed only at entities or persons in jurisdictions or countries where access to and use of the information is not contrary to local laws or regulations. Its contents have not been reviewed by any regulatory authority. BMO Capital Markets does not represent that this report may be lawfully distributed or that any financial products may be lawfully offered or dealt with, in compliance with regulatory requirements in other jurisdictions, or pursuant to an exemption available thereunder.

To Australian residents: BMO Capital Markets Limited is exempt from the requirement to hold an Australian financial services licence under the Corporations Act and is regulated by the UK Financial Conduct Authority under UK laws, which differ from Australian laws. This document is only intended for wholesale clients (as defined in the Corporations Act 2001) and Eligible Counterparties or Professional Clients (as defined in Annex II to MiFID II).

To Canadian Residents: BMO Nesbitt Burns Inc. furnishes this report to Canadian residents and accepts responsibility for the contents herein subject to the terms set out above. Any Canadian person wishing to effect transactions in any of the securities included in this report should do so through BMO Nesbitt Burns Inc.

To U.K./E.U. Residents: In the UK, Bank of Montreal London Branch is authorised and regulated by the Prudential Regulation Authority and the Financial Conduct Authority ("FCA") and BMO Capital Markets Limited is authorised and regulated by the FCA. The contents hereof are intended solely for the use of, and may only be issued or passed on to, (i) persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (ii) high net worth entities falling within Article 49(2)(a) to (d) of the Order (all such persons together referred to as "relevant persons"). The contents hereof are not intended for the use of and may not be issued or passed on to retail clients. In an E.U. Member State this document is issued and distributed by Bank of Montreal Europe plc which is authorised and regulated in Ireland and operates in the E.U. on a passported basis. This document is only intended for Eligible Counterparties or Professional Clients, as defined in Annex II to "Markets in Financial Instruments Directive" 2014/65/EU ("MiFID II").

To Hong Kong Residents: This document is issued and distributed in Hong Kong by Bank of Montreal ("BMO"). BMO is an authorized institution under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) and a registered institution with the Securities and Futures Commission (CE No. AAK809) under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). This material has not been reviewed or approved by any regulatory authority in Hong Kong. Accordingly the material must not be issued, circulated or distributed in Hong Kong other than (1) except for "structured products" as defined in the Securities and Futures Ordinance, in circumstances which do not constitute it as a "Prospectus" as defined in the Companies Ordinance or which do not constitute an offer to the public within the meaning of that Ordinance, or (2) to Professional investors as defined in the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules made thereunder. Unless permitted by the securities laws of Hong Kong, no person may issue in Hong Kong, or have in its possession for issue in Hong Kong this material or any other advertisement, invitation or document relating to the products other than to a professional investor as defined in the Securities and Futures Ordinance and the Securities and Futures (Professional Investor) Rules.

To Korean Residents: This material is not provided to make a recommendation for specific Korean residents to enter into a contract for trading financial investment instruments, for investment advising, for discretionary investment, or for a trust, nor does it constitute advertisement of any financial business or financial investment instruments towards Korean residents. The material is not provided as advice on the value of financial investment instruments or any investment decision for specific Korean residents. The provision of the material does not constitute engaging in the foreign exchange business or foreign exchange brokerage business regulated under the Foreign Exchange Transactions Act of Korea.

To PRC Residents: This material does not constitute an offer to sell or the solicitation of an offer to buy any financial products in the People's Republic of China (excluding Hong Kong, Macau and Taiwan, the "PRC"). BMO and its affiliates do not represent that this material may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any applicable registration or other requirements in the PRC, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. This material may not be distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations.

Singapore Residents: This document has not been registered as a prospectus with the Monetary Authority of Singapore and the material does not constitute an offer or sale, solicitation or invitation for subscription or purchase of any shares or financial products in Singapore. Accordingly, BMO and its affiliates do not represent that this document and any other materials produced in connection therewith may lawfully be circulated or distributed, whether directly or indirectly, to persons in Singapore. This document and the material do not and are not intended to constitute the provision of financial advisory services, whether directly or indirectly, to persons in Singapore. This document and any information contained in this report shall not be disclosed to any other person. If you are not an accredited investor, please disregard this report. BMO Singapore Branch does not accept legal responsibility for the contents of the report. In Asia, Bank of Montreal is licensed to conduct banking and financial services in Hong Kong and Singapore. Certain products and services referred to in this document are designed specifically for certain categories of investors in a number of different countries and regions. Such products and services would only be offered to these investors in those countries and regions in accordance with applicable laws and regulations. The information is directed only at persons in jurisdictions where access to and use of such information is lawful.

To Thai Residents: The contents hereof are intended solely for the use of persons qualified as Institutional Investors according to Notification of the Securities and Exchange Commission No. GoKor. 11/2547 Re: Characteristics of Advice which are not deemed as Conducting Derivatives Advisory Services dated 23 January 2004 (as amended). BMO and its affiliates do not represent that the material may be lawfully distributed, or that any financial products may be lawfully offered, in compliance with any regulatory requirements in Thailand, or pursuant to an exemption available under any applicable laws and regulations.

To U.S. Residents: BMO Capital Markets Corp. furnishes this report to U.S. residents and accepts responsibility for the contents herein, except to the extent that it refers to securities of Bank of Montreal.

These documents are provided to you on the express understanding that they must be held in complete confidence and not republished, retransmitted, distributed, disclosed, or otherwise made available, in whole or in part, directly or indirectly, in hard or soft copy, through any means, to any person, except with the prior written consent of BMO Capital Markets.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

BMO Financial Group (NYSE, TSX: BMO) is an integrated financial services provider offering a range of retail banking, wealth management, and investment and corporate banking products. BMO serves Canadian retail clients through BMO Bank of Montreal and BMO Nesbitt Burns. In the United States, personal and commercial banking clients are served by BMO Harris Bank N.A., (Member FDIC). Investment and corporate banking services are provided in Canada and the US through BMO Capital Markets.

BMO Capital Markets is a trade name used by BMO Financial Group for the wholesale banking businesses of Bank of Montreal, BMO Harris Bank N.A. (member FDIC), Bank of Montreal Europe p.l.c., and Bank of Montreal (China) Co. Ltd, the institutional broker dealer business of BMO Capital Markets Corp. (Member FINRA and SIPC) and the agency broker dealer business of Clearpool Execution Services, LLC (Member FINRA and SIPC) in the U.S., and the institutional broker dealer businesses of BMO Nesbitt Burns Inc. (Member Investment Industry Regulatory Organization of Canada and Member Canadian Investor Protection Fund) in Canada and Asia, Bank of Montreal Europe p.l.c. (authorised and regulated by the Central Bank of Ireland) in Europe and BMO Capital Markets Limited (authorised and regulated by the Financial Conduct Authority) in the UK and Australia.

© Registered trademark of Bank of Montreal in the United States, Canada and elsewhere.

™ Trademark Bank of Montreal in the United States and Canada.

© COPYRIGHT 2020 BMO CAPITAL MARKETS CORP.

A member of BMO Financial Group