Global Economics

Year Ahead 2022: Temporary heat wave or sustained global warming?

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Economics
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Global letter: Temporary heat wave or sustained global warming?

As supply constraints ease, the US should once again start to outperform its peers. China likely will be a reluctant laggard. An incomplete recovery should mean benign policy tightening as inflation drops below target in the major DMs besides the US. The main risk is that inflation does not come down as much as expected, triggering a classic policy-driven recession.

United States: Waking up the supply side

While 2021 was a story of excess demand and a dearth of supply, we think 2022 will be one of rebalancing, albeit only gradually. Inflation will cool from the current highs but remain well above target, leaving the Fed to move into action. Look for three hikes in 2022 starting in June. Future COVID waves are the biggest downside risk. On the upside, the supply-side wakes up to meet the gains in demand.

Euro Area: Moving into the long-term recovery

After -6.5% in 2020, we expect the Euro area to grow at 5.0%, 3.6% and 2.1% in 2021-23, reaching pre-crisis trends in late 2023. Energy and bottlenecks keep inflation high until late 2022. We forecast 2.4%, 2.4% and 1.6% in 2021-23, with core at 1.5% in 2023.

Japan: Climbing the wall of worry

The post-COVID recovery lost steam in 2021 due to repeated COVID waves and supply constraints in manufacturing. Inflation will rise from the current lows, but the pick-up in ex-energy core will remain gradual, delaying policy tightening.

UK: Volatile Kingdom

Strong 2021 UK growth will likely subside to more normal rates in 2022 and probably below trend growth in 2023 in our view. We expect 6.9% GDP growth in 2021, 4.1% in 2022 and slightly below trend 1.3% in 2023.

Canada: Still growing above potential

We expect GDP growth at 3.8% in 2022 after a 4.6% growth rate in 2021. Growth will be sustained by strong US growth, high oil prices and high savings.

Australia: Above-trend growth in 2022

Economic reopening, pent-up demand and stimulatory monetary and fiscal policy should see above-trend growth of 4.0% over 2022. We see the RBA raising in 4Q 2022.

China: Policy easing offers hope for stabilization

We maintain our below-consensus growth forecasts for China at 7.7% and 4.0% in 2021 and 2022 respectively. We continue to see stiff headwinds on domestic demand growth.

ASEAN: Recovery extends into 2022

With significant progress on the vaccination front and a shift to 'living with Covid' strategy, we expect domestic demand to rebound strongly in 2022.

EEMEA: It's getting interesting

2022 is likely to see lower growth and lower – but sticky – inflation across the region. Most central banks will continue to tighten, including in the CEE countries, Israel and South Africa. Russia, is likely to start an easing cycle.

LatAm: Losing steam

We expect LatAm to slowdown in 2022. We forecast 2.2% growth after a faster than expected recovery in 2021. A less favorable global backdrop, hawkish central banks, fiscal consolidation and political uncertainty will all represent headwinds for growth.

Table of Contents

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Global letter

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Temporary heat wave or sustained global warming?

In the past year the big story was Covid and its cure. Hence, we came into 2021 expecting Covid cases to weigh on growth, but for growth to heat up as vaccines rolled out. Two subsequent developments added to the heat. First, when the Democratic Party swept Congress, it quickly became clear that the US was going pour unprecedented fiscal stimulus on the fire, shifting the US recovery from hot to red hot. Second, by the third quarter strong global demand was running up against supply constraints, triggering a nasty bout of inflation. Looking ahead, here we argue:

- As supply constraints ease, inflation will fall even as growth accelerates.
- The US will resume its role as an engine of global growth, while China will be a reluctant laggard.
- An incomplete recovery means that inflation is likely to fall back below target in most major economies. The US will be a notable exception.
- Moderate inflation and partial recoveries in much of the world means a relatively benign tightening cycle. Again, the US is an exception.
- The main risk is that inflation does not come down as much as expected, triggering a classic policy-driven recession.

Growth: from rehab to performance enhancement

As this goes to print, the global economy is already starting to rebound from the Delta shock. In the coming months we see a gradual easing of supply constraints, as workers return to the job market, the production of key components picks up and transportation bottlenecks ease. However, this will take a number of months to play out and a full recovery in the supply side of the global economy is unlikely. While there have been some offsetting revisions, overall we have raised our growth forecast from a year ago, with stronger growth in the US and Euro Area more than offsetting surprising weakness in China (Exhibit 1).

Exhibit 1: GDP forecasts from a year ago and today
We have raised our growth forecast from a year ago, with stronger growth in the US and Euro Area

(percent)	2021E		2022E		2023E
	Old*	New	Old*	New	Current
Global	5.4	5.8	3.9	4.3	3.5
US	4.5	5.6	3.0	4.0	2.2
Euro Area	3.9	5.0	2.7	3.6	2.1
China	8.5	7.7	5.6	4.0	5.3
Developed Markets	4.1	4.9	3.0	3.8	2.2
Emerging Markets	6.3	6.4	4.6	4.6	4.4
Emerging Asia	7.7	6.7	5.3	5.3	5.2
Emerging EMEA	3.4	5.0	3.4	3.6	3.3
Latin America	3.8	6.9	2.8	2.2	2.2

*From year-ahead publication in November 2020
Source: BofA Global Research

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We expect an uneven recovery as some countries move back to pre-Covid trends, but many do not. One way to gauge the strength of the recovery is to calculate average growth for the recession and the three years of recovery. If this average is below the normal trend growth rate, it suggests an incomplete recovery. By this metric, the US overshoots its trend next year but the Euro Area does not fully recover until the end of 2023. China and most other emerging markets are also expected to have incomplete recoveries. Note that in China, aggressive credit tightening in the property sector is expected to cause almost as much economic disruption as the pandemic.

Inflation: It's not all temporary

It's been a bit nerve wracking to watch the recent very strong inflation readings. In the summer, most of the increase was driven by spikes in specific sectors, but in the last few months the pressure has moved into the middle of the inflation distribution. For example, seven developed market economies publish "trimmed mean" measures of inflation that eliminate the highest and lowest parts of the inflation distribution. With one exception all have picked up substantially in the last few months, with a particularly big acceleration in the US. Relative to a year ago, we have raised our global CPI inflation forecast for this year from 2.4% to 3.9% and for next year from 2.8% to 3.8%.

The question for forecasters is: how much will inflation fade over the course of next year? Clearly a major portion of the increase is related to near-term supply constraints. However, it takes two to tango: the surge in prices is due to strong aggregate demand running up against limited supply. At this stage we expect inflation to drop below central bank targets in most major economies over the next year. However, yet again, the US is a notable exception. Even as short-run supply restraints ease, very rapid demand growth suggests that by the middle of next year the economy will breach full employment and potential GDP.

Our FX team has developed a nice graphic that compares inflation pressures across the G-10 (Exhibit 2). The US stands out with the highest core inflation, the smallest output gap, the most accommodative fiscal policy and high inflation surprises compared to most of the rest of the G10. Relative to the Taylor Rule, the US also has very loose monetary policy. New Zealand, the UK and Canada follow. At the other extreme, the list includes Japan, Norway, Switzerland and Australia, with Sweden and the Eurozone in the middle.

Exhibit 2: Heatmap of inflation risks (red for high, green for low, in relative terms)[1]
The US stands out with the highest core inflation, the smallest output gap, and the most accommodative fiscal policy

	Total	Core inflation	Taylor spread	Output gap	Inflation surprises	Change in structural budget deficit
USD	46	10	8	10	8	10
NZD	38	7	4	9	10	8
GBP	37	8	9	4	7	9
CAD	33	9	10	7	5	2
EUR	26	6	7	1	9	3
SEK	24	4	2	8	4	6
AUD	21	5	6	3	3	4
CHF	20	2	5	5	1	7
NOK	19	3	3	6	2	5
JPY	11	1	1	2	6	1

Source: BofA Global Research. Liquid Insight: The inflation era, November 16, 2021.

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Policy: Yes, central banks can control inflation

A popular myth in the markets is that recent inflation is entirely supply-driven and central banks can't do anything about it. We agree that in the short run there is little policymakers can do. But in the medium term they have the tools to manage the demand side of the picture. Hence, they can calibrate policy so that aggregate demand does not create above-target inflation after near-term supply constraints ease.

[1] Liquid Insight: The inflation era

In many cases that means staying the course. With low inflation and inflation expectations, Izumi Devalier and team think the Bank of Japan is on hold for the indefinite future. Ruben Segura and team expect the Euro Area to hit full employment by the end of 2023, but for core inflation to settle in at 1.5%. They look for a lot of noise around the ECB, but no hikes until 2024 or later. China needs to ease, not tighten, credit conditions. And for economies most tied to the US, reluctantly shadowing the Fed seems inevitable.

Finally, at some point the Fed will need to admit that the rise in inflation is not all temporary and it will need to tighten in a way that creates some restraint on financial conditions. Michelle Meyer and team expect eight 25bp rate hikes—one every other meeting—from June of next year to March 2024. Whether that proves to be too fast or too slow will depend on (1) how sensitive markets are to the shock and (2) whether the Fed is facing a modest or serious inflation problem. It has been a long time since investors experienced a get-tough Fed tightening. This could get interesting.

Risks: more than the usual suspects

The global economy faces a number of fairly obvious tail risks:

- Helen Qiao and team worry about an even longer delay in policy easing in China. Not only is their 4.0% forecast for next year below consensus, but the risks to it are also to the downside.
- Our sense from health experts is that there is unlikely to be a significantly worse Covid variant in the next year or so, but we certainly can't rule that out.
- There is also considerable uncertainty about how relations between China and the West will develop. A rapid unravelling of economic interlinkages could trigger a global recession.

Beyond the usual suspects, perhaps the biggest concern is that high inflation sticks. Three things will determine whether inflation stays above central bank targets: the strength of demand, long-run damage to the supply side of economies and the evolution of inflation expectations. The US stands out with its monetary- and fiscal-fueled demand growth and already-strong inflation expectations, but the supply-side issues are global in nature. It will take time to determine if a return to the pre-crisis trend in GDP is inflationary or not. It has been a long time since the major central banks have gone to battle against serious inflation, but if they did, that would greatly increase the risk of a recession.

United States

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Waking up the supply side

- While 2021 was a story of excess demand and a dearth of supply, we think 2022 will be one of rebalancing, albeit only gradually.
- Inflation will cool from the current highs but remain well above target, leaving the Fed to move into action. Look for three hikes in 2022 starting in June.
- We are not out of a pandemic economy and future COVID waves are the biggest downside risk. On the upside, the supply-side wakes up to meet the gains in demand.

We also released our 2022 US Calendar of Business Indicators.

What we got right, what we got wrong

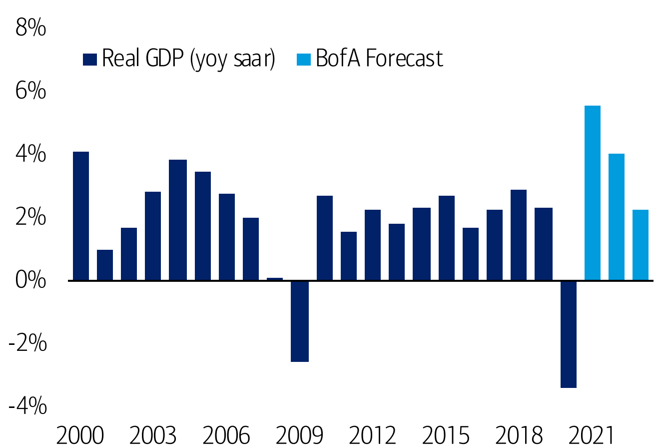
Before we look ahead to 2022 and beyond, we have to judge our forecasts at this time last year. It is a pretty simple assessment: we were right on the incredible strength in demand, but we were wrong when it came to the supply-side. We underestimated the extent to which the supply-side would remain constrained by clogged supply chains and a restrained labor force. As such, inflation has surprised to the upside.

While 2021 was a story of excess demand and a dearth of supply, we think 2022 will be one of rebalancing, albeit only gradually. This should take some of the heat off of inflation but not quickly enough, leaving the Fed to hike three times starting in June and continuing on a quarterly cadence.

Demand vs supply: 4% real GDP growth in 2022

The demand picture is still favorable with consumers able to spend and businesses eager to invest. Consider the fundamentals: there is plenty of cash on household and corporate balance sheets, access to inexpensive credit and powerful positive wealth effects. The data point to robust labor demand given elevated job openings, an inventory restock after a pandemic fueled depletion, and rapid investment in technology and IP to support productivity growth. Working in the other direction is the supply side where clogged supply chains are delaying the inventory rebuild, a stagnant labor force is leaving job openings stubbornly high and rising inflation is weighing on consumer sentiment.

Exhibit 3: Real GDP growth, history and forecasts, %yoy
The economy grew much faster in this cycle than the last



Source: BofA Global Research, Bureau of Economic Analysis
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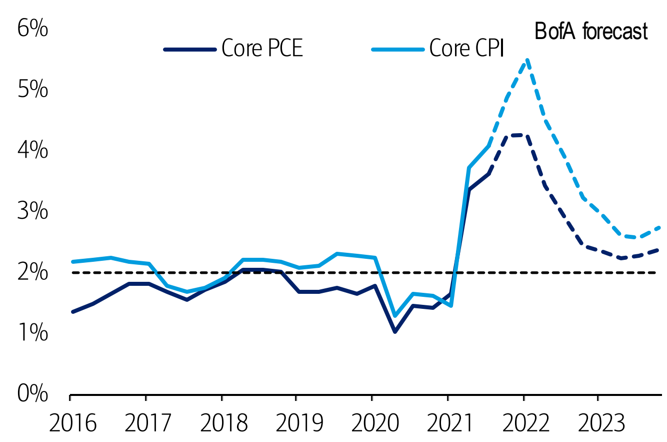
Exhibit 4: Core inflation, recent history and forecasts (% yoy)
Core inflation will cool but remain at elevated levels



Source: BofA Global Research, Bureau of Economic Analysis, Bureau of Labor Statistics
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We think these cross currents will leave growth to slow in 2022 relative to 2021 but still remain at more than double the pace of trend growth (Exhibit 3). We forecast 2022 real GDP growth of 4% with a stronger first half than second half. Of the 4% growth, we estimate that 0.8pp will be due to the inventory cycle and hence 3.2% from final demand. On the upside, consumer spending will remain strong, corporate investment in equipment (ie capex) solid and intellectual property robust. This will offset modest weakness in both residential and nonresidential structures investment as well as further drag from a widening trade deficit. Beyond that in 2023, we expect real GDP growth of 2.2%—closer to trend.

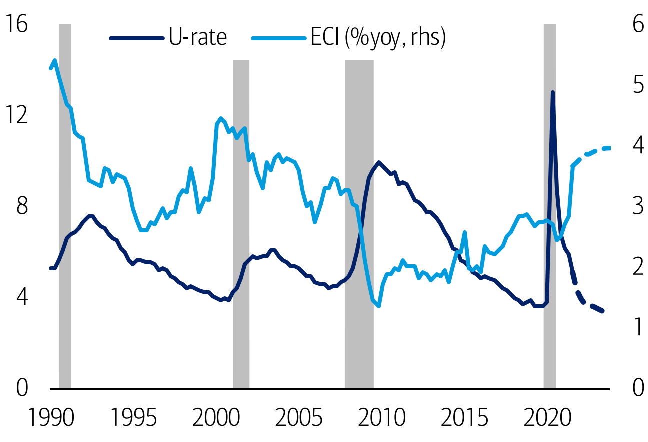
Our forecast accounts for the latest policy changes including passage of the Bipartisan Infrastructure Bill (BIF) as well as the likely passage of Build Back Better (BBB), which combined will total around $2tn in new spending. The BIF has little impact on near-term growth but BBB will work to support lower income purchasing power into 2022.

Inflation: well above target

The story for next year will be continued above-target inflation with a shift in the composition of price pressures. Persistent inflation pressures will likely accelerate while "transitory", which should be viewed as pandemic-related/reopening pressures, moderates but remains relevant for broader core inflation. We expect core PCE to settle around 2.4% yoy by the fourth quarter (4Q/4Q), while core CPI cools to a still-hot 3.2% yoy clip (4Q/4Q) of 2022 (Exhibit 4). In 2023, we expect core inflation to remain elevated with YE core PCE of 2.4% and core CPI of 2.8%.

A key development for persistent inflation are wages and inflation expectations. The Employment Cost Index (ECI) reached 3.7% yoy in 3Q, which is the strongest wage growth since 4Q 2004. While part of the strength can be attributed to productivity—up 1.6% annualized since the pandemic—the labor market has tightened rapidly with the unemployment dropping to 4.6% in October. The slow return in the labor supply has contributed to these frictions, and we expect only gradual improvement going forward. Strong hiring demand will more than compensate and allow for the unemployment rate to drop to 4%—in the vicinity of the non-accelerating inflation rate of unemployment (NAIRU)—by 1Q 2022 and to 3.6% by the end of 2022. A traditionally tight labor market should allow for sustained wage acceleration (Exhibit 5). Long run inflation expectations have also rebounded, with the Fed's index of Common Inflation Expectations (CIE) rising to 2.06% in 3Q from the trough of 1.93% in 2Q 2020. We think the risks are for further increase given the likely elevated inflation backdrop next year, which will then feed back into underlying price pressures.

Exhibit 5: Unemployment rate and ECI wages
U-rate to reach a low of 3.2% by end of 2023, sending wages higher



Source: BofA Global Research, Bureau of Labor Statistics

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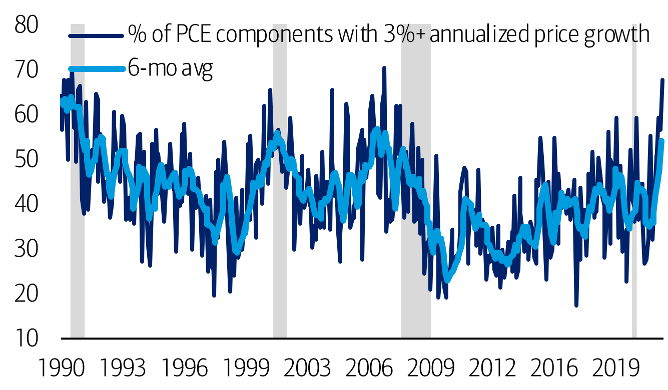
Exhibit 6: % of PCE basket seeing greater than 3% annualized price growth
Elevated inflation pressures are becoming more broad based



Source: BofA Global Research, Dallas Fed

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As we learned in recent CPI reports, owners' equivalent rent and rent of primary residences have shifted into higher gear, averaging a 0.4% mom clip. High frequency rent indicators such as CoreLogic, Zillow, and ApartmentList are all up double digits on a % yoy basis as of their latest readings, suggesting a strong outlook for 2022. Rents are by far the biggest cyclical driver of inflation and will underpin persistent price pressures. We are also seeing a broadening of inflation pressures, which is difficult to dismiss. First, the share of PCE inflation components that saw 3%+ annualized inflation in September reached 67.9%, which is the highest February 2007 (Exhibit 6). Second, trimmed mean (TM) measures of inflation have accelerated with TM CPI at 4.1% yoy as of October and TM PCE at 2.3% as of September.

We are likely not done with "transitory" price gains, primarily evident within goods. As we detailed in When cost-push comes to shove, supply chains remained clogged with port congestion at record highs and retail inventories/sales ratios at record lows. Auto production in particular is expected to be choppy throughout 1H next year, with stabilization in the back half and inventory replenishment a 2023 story. At the same time, retailers are adapting to constrained supply chains—for example, the holiday shopping season has been pulled forward this year. Overall, we look for additional core goods inflation in 2022, but more modest compared to 2021.

Fed: fighting to keep credibility

We think the Fed will begin hiking rates in June to fight inflation and prevent expectations from becoming unhinged on the upside. We then expect the Fed to stay with a quarterly cadence, hiking at every other meeting, which leaves 3 hikes in 2022, 4 hikes in 2023 and 1 hike in 2024 to end with a terminal rate of 2-2.25%. The end point is up for debate. The markets are skeptical assuming the Fed won't get to 2%. The challenge will be for the Fed to bring inflation under control but to do so delicately to avoid short circuiting the business cycle—the elusive soft landing. Of course, if the Fed sees the economy or markets suffer with high rates, they can also pause the hiking cycle and allow the economy time to adjust before resuming a path toward higher rates.

Along with a hike in June, we think the Fed will end tapering earlier, concluding in May, simply forgoing the last month of reductions in June and instead tapering by the remaining $20bn in Treasuries (TSY) and $10bn in mortgage-backed securities (MBS) in May. Fed officials are likely to be very careful regarding the communication of policy changes. We expect an emphasis on patience through yearend as Fed officials continue to analyze data, particularly the labor data, with hopes that the supply-side wakes up quickly enough. By early next year, we think the conversation will shift as the Fed sets up for the change in policy with language shifting by the March meeting.

Risks: COVID and inflation

The risks center around the path of COVID – additional waves of COVID can set back the economic recovery and delay the reopening of the supply side. As we observed with the Delta variant, the rise in COVID cases prompted consumers to reduce spending on travel and entertainment. On the other hand, if COVID cases remain low and people transition from the "pandemic economy", we will see a more sustained and healthy rise in services spending. We are also keenly focused on the path of inflation. A big risk is if inflation expectations become unhinged on the upside and force the Fed to hike even faster and more aggressively, short circuiting the business cycle.

Euro Area

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Moving into the long-term recovery

- After -6.5% in 2020, we expect the Euro area to grow at 5.0%, 3.6% and 2.1% in 2021-23, reaching pre-crisis trends in late 2023.
- Energy prices and bottlenecks keep inflation high until late 2022. We forecast 2.4%, 2.4% and 1.6% in 2021-23, with core at 1.5% in 2023.
- We don't expect a rate hike before 2024. But the ECB won't commit to QE or no hike beyond 2022. That creates plenty of noise.

Trying to find a new normal

Last year's focus was on the timeline and scope of reopening. In the Euro area, that started later but eventually went faster and further than we dared to hope. Inflation in the region, like elsewhere, was the bigger surprise, the result of a mix of bottlenecks and energy price surges. Uncertainty on the immediate growth outlook is up again amid rising COVID incidence, though arguably lower still then last year. But, although the recovery looks strong, insufficient fiscal support during the height of the pandemic will make the difference to the US more blatant.

Policy choices remain complicated in the Euro area, as usual. Given the inflation surge on the back of bottlenecks and energy prices, an almost unconditionally patient ECB, as we expected last year, is no longer a given. We remain firmly in the transitory inflation camp. And although ECB forecasts suggest the same for the central bank, its willingness to pre-commit to policy (rates and asset purchases) beyond 2022 will be limited. That creates a path for a mid-2023 rate hike, which markets would have to price. Markets will have to question the fate of asset purchases beyond 2022, too.

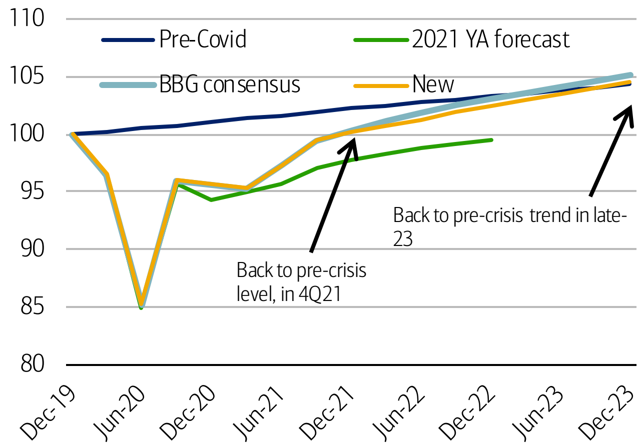
We don't think the ECB will hike anytime soon. No hike before 2024 remains our call. We also expect data to force the ECB to continue asset purchases until late 2023. But the ECB trajectory is less obvious now than it was a year ago.

Growth: entering stage 3 of the pandemic

Our recent forecast change remains broadly intact at Euro area level, with GDP growth at 5.0% this year (-10bp), 3.6% in 2022 and 2.1% in 2023 (+10bp). Our scenario remains below Bloomberg consensus (5.1%, 4.2%, 2.2% for 2021-23), especially for next year. A large chunk of the difference is driven by 4Q21/1Q22 expectations. A purchasing power squeeze and weaker China are part of our base case now. A country-specific but short lockdown in select countries (Germany, among the big members) is now part of our 4Q21 scenario. Elsewhere, we assume COVID disruptions to be more contained.

Our fundamental views on the recovery are unchanged: last year, we split 2020-22 into three stages: lockdown, reopening, and the long-run recovery. In 2022, we will be moving into the third stage (pandemic developments in the coming months permitting), ie the long-term recovery. GDP stood 0.5% below pre-crisis levels in 3Q21 (vs 3% expected then), so the starting point is better. It reduces permanent income loss, but doesn't make it disappear. Permanent scarring, resource reallocation needs from potential perpetual shifts in demand, risks of latent insolvencies, etc, should become more topical next year, as it becomes obvious that the US and Euro area recoveries are not alike.

Exhibit 7: Euro area GDP forecasts in level terms (4Q19=100)
The mechanical bounce-back was better than feared



Source: Bloomberg, Eurostat, BofA Global Research

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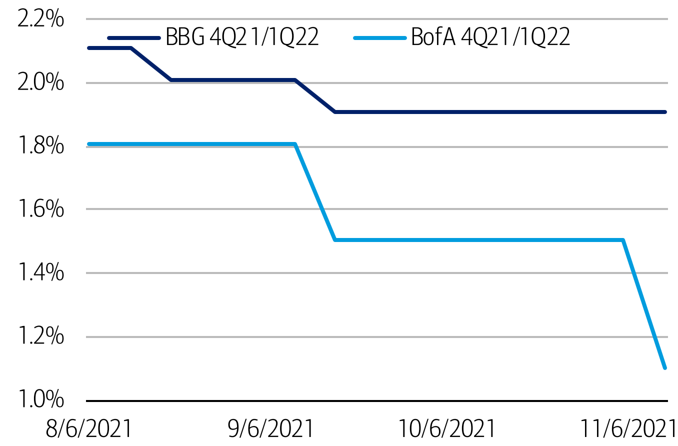
Exhibit 8: Cumulative 4Q21/1Q22 expectations
Purchasing power squeeze, China, Covid – consensus is following us



Source: Bloomberg, BofA Global Research

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Inflation: being alert does not mean ringing the alarm bell

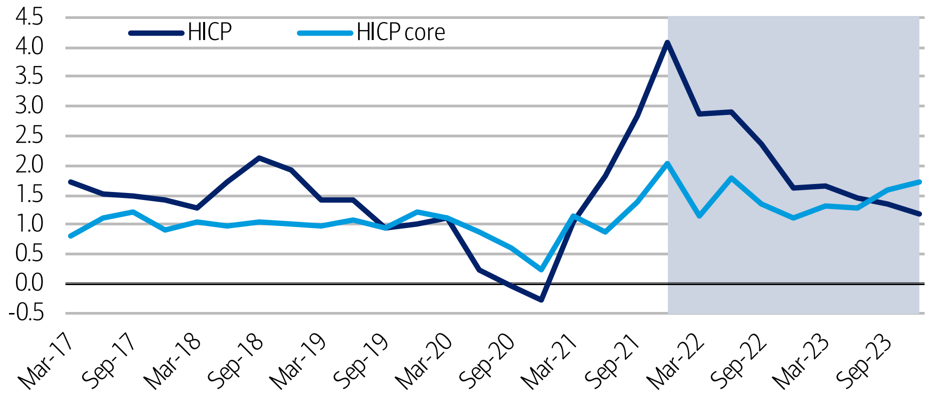
Like elsewhere, our inflation forecasts today look very different from a year ago. We now forecast headline inflation at 2.5% this year, 2.4% next and 1.6% in 2023, unchanged from our recent update, but much higher than the sub-1% we expected for 2021/22 last year. Our core inflation forecast, too, has moved from below 1% to 1.4% for this year and next and 1.5% in 2023.

There are multiple factors to blame in Europe: changes in weights have created considerable noise since the start of the year, but manufacturing bottlenecks and, crucially, energy prices (natural gas, in particular) were the bigger surprises. Both should fade, eventually. We remain firmly in the "transitory" inflation camp, even if that means headline inflation will take until late 2022 to correct below 2% again.

Of course, we remain alert to signs of more meaningful inflationary pressures. Wage growth monitoring will be (one of our) full-time jobs next year. Our working assumption is that wage growth will normalize to 2.5-3% in the Euro area, back to pre-crisis rates. Inflation optimists will make a lot of noise during that period, because it won't be easy to check if wage growth is "just normalizing" or moving up further.

The latter would require a regime shift, almost. That's not entirely impossible (and to be clear, it would be much needed to actually reach the ECB's inflation target in the medium to long term). But that still strikes us as a tail risk given unanchored inflation expectations, a persistent GDP gap to pre-crisis trends, and being already a quite long way back to "normal".

Exhibit 9: Euro area inflation forecast
Headline inflation will stay above 2% for most of 2022 before correcting lower again



Source: Eurostat, BofA Global Research

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An imperfectly and reluctantly supportive central bank

We expect no hikes from the ECB until 2024 at the earliest and for asset purchases to last until the end of 2023. But delivery matters. However, the profound disagreement on the amount of stimulus needed to avoid the chronic insufficiency of aggregate demand of the 2010s and the lack of conviction on inflation beyond 2023 will force the central bank to keep as much optionality as possible.

That calls for a reactive central bank that provides too short forward guidance. This is not new; these dynamics have been with us since the ECB, in December 2020, decided to "preserve" rather than to try harder. To us that means that in the next meeting the ECB communicates that Pandemic Emergency Purchase Programme (PEPP) will still end in March, with a reduced pace in 1Q. It will also tell us that APP will move to EUR40bn then. Forward guidance on Asset Purchase Programe (APP) will be changed, replacing the "shortly before" with date-dependent forward guidance.

Given increased uncertainty around COVID a trickle (whatever is left) of PEPP purchases after March can't be ruled out but we would expect the programme, as it is today, to still end by then. We would need a much broader spread of COVID incidence across the region for a proper PEPP extension.

Optionality to be able to hike in 2023 if inflation stays stronger than the ECB expects would call for it to announce in December that APP would continue "at least until September or December 2022." If they went for September that would leave December wide open for the market to price hikes at the end of 2022. On the margin, we think a desire to push the markets to price out hikes in 2022 makes "at least until December" more likely. Then, eventually, data will reluctantly push it into extending APP beyond that at EUR20bn per month.

But the path matters. Inflation likely will be high and well above target in 1H22. New forward guidance will help with pricing out hikes in 2022 but will likely force markets to price more hikes into 2023. There is unlikely to be strong pushback from the ECB in 1H22 given inflation developments. And certainly, the market will have to question the future of APP beyond 2022 during the period. ECB speakers won't help with these dynamics. It will be a very volatile path.

Details matter

While we expect a monthly flow of EUR40bn until the end of 2022 we have low conviction on exactly how this will be delivered. Monthly flow, on the margin, is our preferred option. But the inability to pre-commit beyond the next quarter we have seen with PEPP could be carried over to the revamped APP. In other words, with the aim of "preserving favourable financing conditions" we could see: i) the monthly quantum being revised every quarter; ii) an envelope that gets spent a bit more flexibly according to market conditions, with quarterly reassessments; or iii) a combination of both a EUR20bn flow per month plus a flexible envelope of EUR180bn available throughout 2022.

By flexibility we refer to the timeline of purchases. Our working assumption is still that the 33% issuer/issue limit won't be the key constraint while the 50% on consolidated holdings should not be binding in the path we expect.

We are not convinced capital key flexibility will carry over to APP from PEPP and we are wary of "virtual programmes". But we would expect the ECB to make use of PEPP reinvestments, likely extended to the end of 2024, to deviate from the capital key if/when needed.

Finally, we would expect targeted longer-term refinancing operations (TLTROs) to be extended, but with the discount not going beyond what's already been announced.

Risks: avoiding repeating old mistakes

To us the biggest risk for 2022 is that of repeating, qualitatively, old mistakes. There was a premature (and very aggressive) tightening of fiscal policy in the 2010s and the ECB was never supportive enough until 2015. 2022 will be the year in which we need to avoid doing the same again.

Our forecasts assume this is not the case and the fiscal stance manages to avoid unwarranted tightening in 2022 and, more importantly, 2023. But this is far from certain.

1. Yes, we assume a supportive central bank but we have discussed in the previous section the many risks around that. ECB-induced volatility is probably a permanent feature now.

2. We also assume that the discussion on reforming fiscal rules that will take place throughout 2022 will avoid a tightening of fiscal policy in 2023.

But this is an assumption with a lot of uncertainty around it. The political backdrop needs to be (fiscally) friendly enough for this to be delivered. And the potentially imperfect compromise (yes, Europe always works with imperfect compromises) not only needs to avoid outdated and ill-designed fiscal rules coming back as they are but must also leave room for the green transition without that transition adding to tightening requirements.

Politics (France and Italy in particular) can add to tensions beyond fiscal rules per se. And of course Covid incidence remains a downside risk for the winter. Our working assumption is that the strategy of the summer (restricting high-risk low-cost activities) will be enough to avoid tougher scenarios and that the endogenous consumer response will be limited. It remains to be seen whether what worked during the warm summer will also work in the colder weather.

We also see a few risks on the upside next year. First, deployment of Next Generation EU (NGEU) funds has been slow in 2021. The challenge was great, and setting up the logistics and governance of implementation has been tricky. But with the machinery in place in most countries already by 2022 the risk is a concentration of NGEU resources that could create a fiscal growth spurt.

Of course, if we end up seeing a fast correction of the energy price strength then that could help purchasing power and, in the short term, diminish hawkish noises from the central bank. Finally, a fast resolution of bottlenecks could create manufacturing upside. The reverse also holds

Japan

Izumi Devalier
BofAS Japan

Takayasu Kudo
BofAS Japan

Climbing the wall of worry

A disappointing 2021

Japan's growth disappointed in 2021, as the economy was hit hard by two inter-related headwinds: 1) the resurgence in Delta-driven COVID cases over the summer; and 2) supply-chain disruptions in the manufacturing sector, especially the auto industry. The former kept a lid on the recovery in in-person services spending. The latter not only hurt exports, production, and capex, but dragged down durable goods consumption. As a result of these headwinds, GDP has effectively gone sideways over the past three quarters, making Japan's recovery one of the slowest among major DMs. We now forecast CY21 growth of 2.0%, significantly weaker than the 3.0% we expected last year.

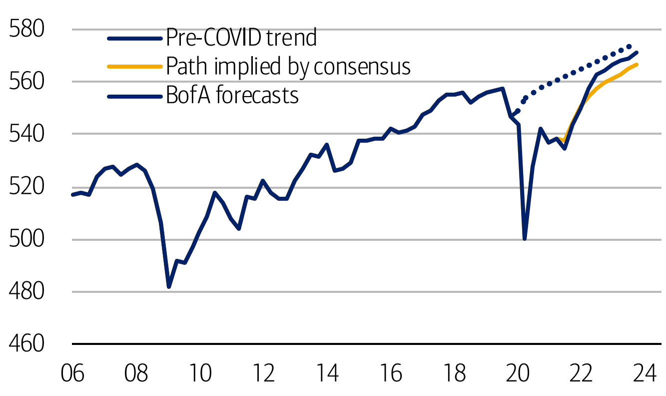
A clearer path to recovery

The good news is that the two big headwinds that stalled the recovery are already abating, setting the stage for a robust rebound in growth over the next couple of quarters. We maintain our projection for an above-consensus 4.0% rebound in CY22, followed by a 1.8% expansion in CY23. As of 3Q CY21, Japan's GDP was 2.3% below the pre-COVID (3Q CY19) peak. We expect the gap to close in 2H CY22, though output will likely remain below the pre-COVID trend for the foreseeable future (Exhibit 10)

On the virus front, Japan has overtaken Canada as the most vaccinated G7 economy. New cases collapsed in September and have stayed low despite the pick-up in mobility over the past two months. Reflecting this, the government has lifted almost all remaining restrictions on restaurants and bars. With in-person services spending categories still stuck between -10% to -50% of pre-COVID levels, according to 2H October credit card spending data, the re-opening rebound has much further to run. The planned, nationwide restart of the "Go To" domestic tourism stimulus program should offer an additional tailwind for consumption in 1Q CY22.

Meanwhile, the worst of the supply chain problems in the auto sector seem to be behind us as the Delta outbreak passes its peak in ASEAN. This should see production and exports improve gradually from late 4Q CY21 onwards as supply bottlenecks ease.

Exhibit 10: Japan real GDP level and forecasts (JPY trn saar)
We expect a sustained rebound in growth from 4Q CY21 onwards



Source: BofA Global Research, JCER
Note: Consensus forecasts are from the JCER ESP survey, conducted 28 Oct - 5 Nov. Quarterly path for FY23 GDP was extrapolated from the median FY23 growth projection of 1.3%YoY.
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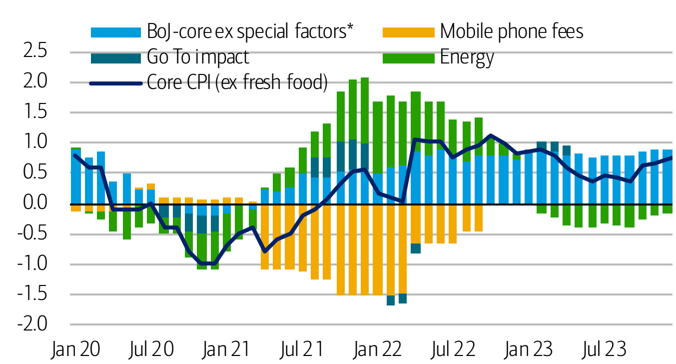
Exhibit 11: Factors driving changes in Japan-style core inflation (CPI ex fresh food)
Actual and BofA forecasts (YoY%)



Source: BofA Global Research, MIAC
*Includes the impact of the October 2019 consumption tax hike, measures to make education free of charge, mobile phone service charges, and the government's "Go To" stimulus program.
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While Chinese demand is likely to remain weak near-term, reflecting the slowdown in the mainland economy, US growth is likely to remain solid, and corporates also face the need to re-stock depleted inventories. The reduction of COVID-related uncertainties should see capex bounce back, as foreshadowed by recent business surveys.

No inflation scare here

Despite the improvement in growth, inflation pressures are likely to be limited to energy-related components: we expect BoJ inflation (CPI ex fresh food and energy) to average 0.0%YoY CY22 and 1.0% in CY23, following an expected 0.5% decline in CY21.

To be clear, a significant part of the current weakness in the Japanese CPI can be explained by the collapse in mobile phone service charges, which is expected to shave 1.5ppt off headline inflation through March 2022, and 0.5ppt until October 2022 (Exhibit 11). However, even adjusting for these special factors, ex-energy core inflation is likely to average 0.6-0.8%YoY for much of CY22 (vs. +0.5% currently) after plateauing at around 1% from CY23 onwards.

Policy to remain accommodative

Subdued inflation means overheating concerns are limited, allowing policymakers to maintain accommodative policy in 2022: on the fiscal front, the new Kishida government will soon unveil its long-awaited economic package. Though the details of the package are still unclear, and we suspect that much of the stimulus represents a re-packaging of some of the JPY30trn (~6% in GDP) in COVID-related emergency response funds that were unspent as of mid-FY21, the bottom line is that there is a lot of government money in the pipeline. The bigger challenge is getting households and corporates to spend the money.

In reality, we expect a large chunk of the net new fiscal injection to either be saved or used by SMEs to pay back loans, which is why we are not factoring in a large GDP boost from the upcoming stimulus package itself. That said, the extra stimulus money offers a layer of insurance to put a floor on incomes, especially in an environment of rising commodity prices.

The weakness in inflation also means that the BoJ is likely to remain a laggard among developed market central banks when it comes to tightening: we expect the central bank to keep its current targets for the short-rate and 10-year target unchanged through at least the end of Governor Kuroda's term (ending April 2023). Instead, the key focus for the BoJ in 2022 will be to scale back its COVID-era emergency lending programs, as it has already done with ETFs and J-REITs. If our economic forecasts are correct, this will be justified in 2H CY22 when the economy recaptures the pre-COVID level.

Speculation over accelerated BoJ normalization may intensify after the July 2022 Upper House elections, when BoJ personnel decisions come into focus. But we think the BoJ is highly likely to stick to the overall YCC framework under the new leadership.

Risks

The risks to our outlook swing in both directions. On the downside, the biggest near-term risk remains the virus situation, both at home and abroad. Additional risks include a disruptive surge in commodity prices, which would cut into private sector incomes and dampen the recovery in domestic demand. Another risk is prolonged weakness in household confidence, which could keep precautionary savings elevated and result in stagnant consumption even after the virus threat fades. Beyond 2022, our biggest concern is pre-mature and overly aggressive fiscal tightening, following the passage of the Upper House elections.

Upside risks include a stronger-than-expected recovery in household sentiment, which could cause more of the JPY20trn (4% of GDP) in forced private sector savings to be unleashed.

UK

Robert Wood
MLI (UK)

Volatile Kingdom

Inflation much higher than we expected

Compared to our last year ahead, growth turned out stronger than we expected and inflation much stronger. The former was mainly a result of fading impacts of Covid on growth – with the 1Q lockdown fall in GDP especially muted. The latter due in part to global supply chain pressures and energy.

From boost to squeeze

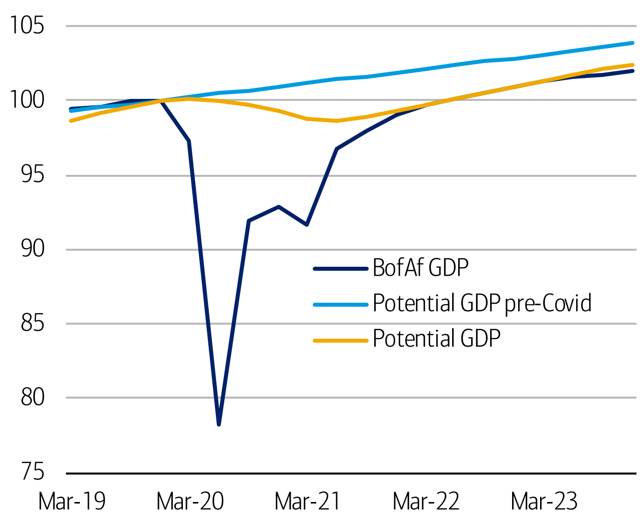
Strong 2021 UK growth will likely subside to more normal rates in 2022 and probably below trend growth in 2023 in our view. We expect 6.9% GDP growth in 2021, 4.1% in 2022 and slightly below trend 1.3% in 2023.

The UK's rapid vaccine roll-out allowed life to return largely to normal through the summer, boosting the economy. That reopening boost has now likely peaked. A real income squeeze and rate hikes replace that reopening boost in 2022. We expect household income to fall 1-2% in 2022. Consumption growth should remain strong in 2022 as households draw on their saving in 2022 but slow below trend in 2023 as saving returns to normal in 2023. Added to the consumption slowdown should be business investment falls, driven by the removal of the 'super deduction' incentive in March 2023.

Drooping below trend in 2023

We assume around 1% lower potential GDP by 2023 than we did before Covid. On our forecasts GDP catches up to that scarred level of potential GDP in 2022 and drops slightly below potential in 2023. We condition these forecast on our forecast for the BoE to hike Bank Rate to 0.5% by end-2022 and 0.75% by end-2023. If we assumed in our forecasts that the BoE hiked rates in-line with market expectations we would expect a considerably larger output gap in 2023 (see note [UK Economic Viewpoint: Triple whammy for consumers 26 October 2021]).

Exhibit 12: UK GDP, 4Q 2019 = 100
Inflation and rate hikes likely to switch UK from strong to softer recovery



BofA estimates of potential GDP. **Source:** BofA Global Research estimates, ONS.

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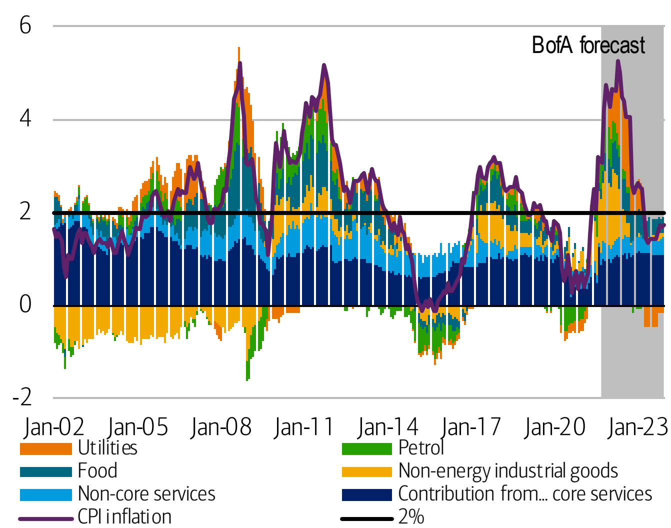
Exhibit 13: UK CPI inflation, % yoy
BofAf inflation to peak at 4.8% then fall temporarily below target in 2023



Source: BofA Global Research, ONS.

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Market rate path vs. our own is more than a technicality

The longer market interest rate pricing diverges from our assumption the weaker our growth forecasts will be. With most UK mortgages now being fixed rate, the impact of monetary policy on the economy depends more than it used to on market expectations for interest rates two and five years ahead than on the level of Bank Rate today.

Inflation falls back to target as supply chain disruptions stop getting worse

Much of the UK's inflation spike has been driven by global factors, especially gas prices and goods (Exhibit 13). We assume supply chain disruptions worsen through to early next year and at no point in our forecast do we assume supply chain disruptions ease. The former means continued above target sequential inflation through to the New Year, the latter means we do not incorporate in our forecast any correction of goods prices back down after their recent extraordinary surge.

Even with those strong assumptions we expect inflation to fall sharply towards, but not all the way to, the BoE's 2% inflation target in late 2022 and below target in 1H 2023. As long as supply disruptions don't forever worsen eventually the impact of higher costs will have fed through to the price level and inflation will fall back. Inflation could fall back further if supply chain disruptions ease in our two year forecast horizon.

Domestic inflation pressures should dictate price increases in the medium. We expect a modest output gap to deliver slightly (10bp) below target core inflation in 2023. Meanwhile we condition our forecasts on the market path for energy prices which implies a utility price cut in late-2022 dragging our headline inflation forecast to 1.8% in 2023. Those conditioning paths change large amounts almost daily, however, meaning there are large risks around our call. Our inflation forecasts are well below market pricing but close to the BoE's scenario in which energy prices follow market expectations.

Policy

2022 will be a year of complex monetary policy changes. We expect the BoE to hike twice by May 2022. At that point the BoE will being passive balance sheet run down, which for their forecasts will involve a judgement about what QT multiplier to incorporate in their numbers. If the BoE gets Bank Rate to 1% as the market expects – but we don't – the BoE would need to communicate an active sales path and a multiplier for that. These decisions are needed quickly on the market path for rates – which reaches 1% next September. The recent on and off BoE communication – can hike before ending QE replaced by Governor Bailey saying he didn't want to hike before ending QE because of the signal –suggests to us potential for confusion.

Volatile Kingdom

Rather than provide a laundry list of where we could be wrong here we highlight one risk we see stemming from a UK paradigm shift. Pre-Brexit and pre-Covid the rules of the UK game seemed stable. An independent central bank guided medium term rate expectations with its inflation forecasts, government policy was generally focused on low deficits with relatively small disagreements about the size of the state, some rules were governed by the EU, and that also gave a safety value for labour shortages.

It seems to us the rules of the game are harder to pin down now, more volatile. Might taxes be raised further (already heading to multi-decade highs) to fund spending commitments? What aims will govern regulatory policy? Can the BoE be as confident in the parameters underlying the economy as it used to be? To put this frankly, the UK has in our view often chosen an inflationary solution to problems recently (e.g. government spending, or wages should rise in response to labour shortages). Brexit disruption is even back on the agenda. The range of economic outcomes for the UK seems genuinely wide at present and increasingly in our view skewed in an inflationary direction.

Canada

Carlos Capistran
BofAS

Still growing above potential

- We expect GDP growth at 3.8% in 2022 after a 4.6% growth rate in 2021. Growth should be sustained by strong US growth, high oil prices and high savings.
- We expect inflation to remain high in 1H 2022, but to move inside the BoC target range (1 – 3%) in 2H 2022. Risks to inflation remain to the upside.
- Fiscal and monetary stimulus likely will be much smaller. The fiscal deficit likely will be cut by more than half and the BoC should begin hiking in April 2022.

A large rebound in 2021

A year ago we expected a large rebound of the Canadian economy and indeed it has had a large rebound. We expect the economy to growth 4.6% this year, which is a reduction from our previous 5% expectation but it is a rate more than twice as high as Canada's average growth rate. Strong growth in the US coupled with large domestic fiscal and monetary policy stimulus (fiscal stimulus above 15% of GDP) contributed to the strong performance despite COVID. The labor market in particular has seen a strong recovery and both employment and participation are back to pre-pandemic levels. The big surprise in 2021 has been high inflation. We expected inflation to average 1.8% but we now expect inflation to average 3.4%, and currently inflation is at 4.7% yoy. High inflation is a global issue, but it is certainly putting pressure on the Bank of Canada (BoC), which already finished tapering and is getting ready to start a hiking cycle.

Still growing above potential

We expect GDP growth at 3.8% for 2022, a cut from our previous expectation of 5% growth. Canada is in a position to have aggregate production back to pre-pandemic levels by 1Q 2022 (Exhibit 15). Canada likely will keep growing above potential in part helped by strong US growth and high oil prices and supported by high savings. Energy exports and non-energy exports ex-autos will continue leading the way in our view (Exhibit 16). One of the highest vaccinations rates in the world should also help. However, we revise our GDP growth expectation down because the auto sector is weak due to the global semi-conductors shortage and because fiscal and monetary policies are withdrawing stimulus. We forecast the fiscal deficit to move to -2.3% of GDP in 2022 from -6.4% in 2021 and we think the BoC will start hiking its policy rate in 1H 2022.

Exhibit 14: Macroeconomic outlook
% year-on-year growth rate, unless otherwise indicated

	2021	2022	2023
Real GDP growth	4.6	3.8	3.5
CPI inflation (avg)	3.4	3.4	2.0
Bank of Canada overnight rate (eop)	0.25	1.00	2.00
CAD (eop)	1.26	1.20	1.00
Brent crude oil ($bbl average)	72.0	85.0	75.0
US real GDP growth	5.6	4.0	2.2
US Fed Funds rate (eop)	0.25	1.00	2.00

Source: BofA Global Research

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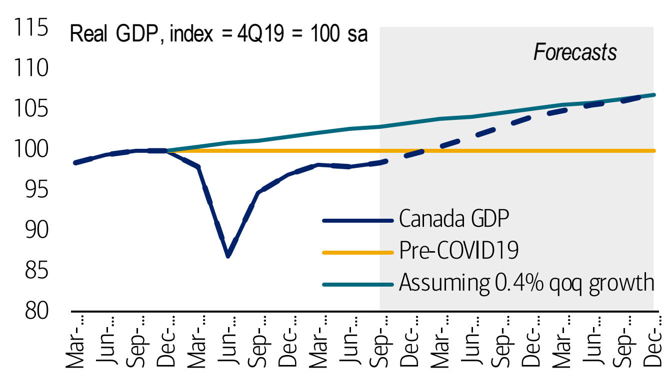
Exhibit 15: Canada GDP
We expect GDP to recover its pre-pandemic level in Q12022



Source: BofA Global Research Stat Canada, Haver

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We still see inflation converging to BoC's target

Inflation is at 4.7% and we expect it to reach 5.0% in December 2021. However, we still expect inflation to be close to 2% by end-2022. Supply disruptions and high energy prices will continue to push inflation to the upside in the next few months. And shelter inflation has soared reaching 4.8% yoy in October. But we continue to expect inflation to return to the BoC's target (1-3%) by 2H 2022 as we expect global supply constraints to ease (Exhibit 17). We do not expect commodity prices increase significantly and with China decelerating we see downside pressures to inflation. Less fiscal and monetary stimulus will also support a slowdown in inflation. Finally, a base effect from high prices in 2021 should benefit inflation in 2022, in particular in 2H 2022. Core inflation is still below 3% (the average of the three core measures that the BoC follows). We believe core inflation can still increase in the following few months, but a switch to services from goods as the economy continues to reopen will help to bring core inflation down.

BoC will likely hike 25bp in April 2022

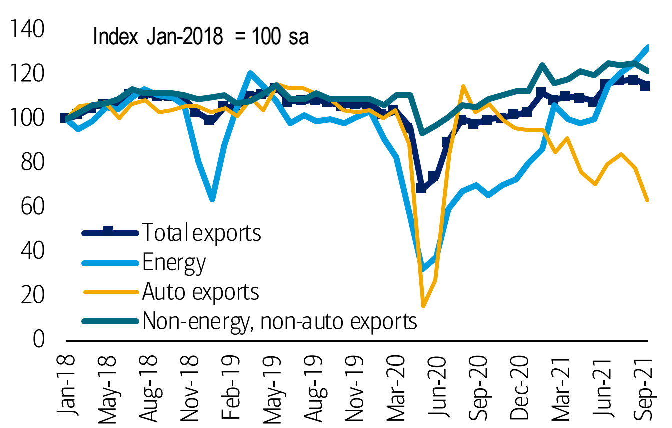
The BoC is done with tapering, earlier than initially expected, and it is currently setting the stage to begin its hiking cycle. BoC's forward guidance is that it will hold the policy interest rate at 0.25% until economic slack is absorbed so that the 2% target is sustainably achieved. The BoC expects that to happen sometime in the middle quarters of 2022. So there are four live meetings for lift-off: April, June, July and September 2022. But only two of those meetings have Monetary Policy Report and press conference: April and July. Given how high inflation is, we believe that the BoC will hike sooner rather than later so we expect the first hike in April 2022. We then expect the BoC to hike 25bp per quarter for a total of three hikes in 2022 and four hikes in 2023.

Balanced risks to growth, upside risks to inflation and therefore to rates

We see balanced risks to our GDP growth forecast for 2022. COVID can cut both ways. Cases are increasing again in Europe and they could increase in Canada, which is negative for growth. But Canada has one of the best vaccination rates in the world and hence new COVID waves may only have a small impact on activity. The balance sheets of many households are strong which is an upside risk. But many households still have high levels of debt and the public debt has also increased substantially, which poses a negative risk to growth given that we expect higher global and domestic interest rates. We see upside risks to inflation especially in the first half of 2022 as inflation is still increasing and supply shortages are still pervasive. Higher inflation will continue to put pressure on the BoC, which could hike more aggressively than what we currently expect.

Exhibit 16: Canada's exports

Total exports are way above pre-pandemic levels, but autos are a drag



Source: BofA Global Research, Stat Canada, Haver

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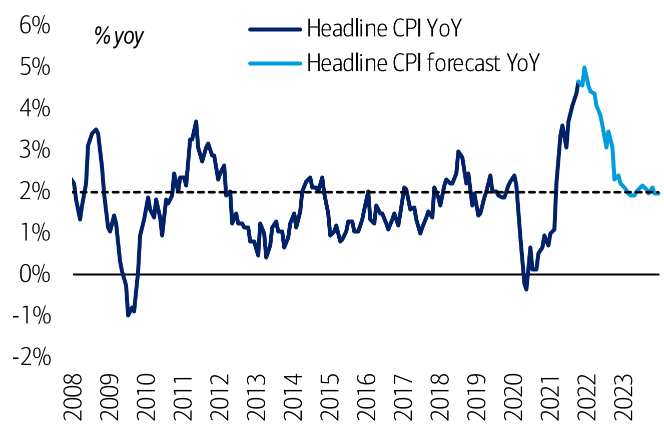
Exhibit 17: We expect inflation to be above 3% most of 2022

We now expect inflation at 5.0% yoy for end-2021 but at 2.2% by end-2022



Source: BofA Global Research, Stat Canada, Haver

BofA GLOBAL RESEARCH

Australia

Tony Morriss
Merrill Lynch (Australia)

Micaela Fuchila
Merrill Lynch (Australia)

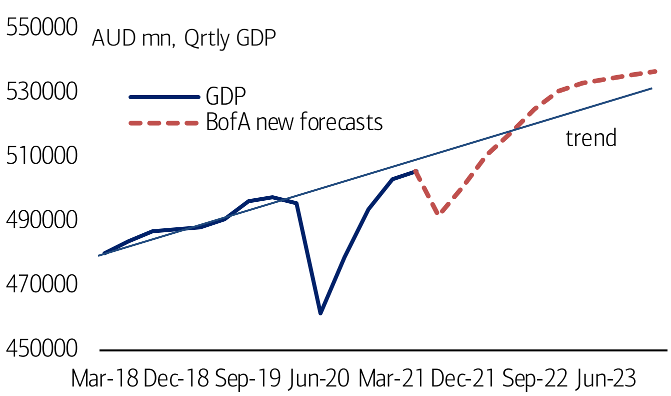
Above-trend growth in 2022

We look for above-trend growth of 4% for the AU economy over 2022. This is lower than current RBA forecasts for 5%, but is above consensus. We see economic conditions for RBA rate hikes in 4Q 2022 due to faster progress on meeting inflation, wages and unemployment targets due to economic reopening, high vaccination rates (heading for 90% of +16yo), pent-up demand and accommodative policy settings. The output gap is likely to close by mid-2022 as we are assuming a lower trend of growth of around 2.5% as population growth is likely to recover only gradually (Exhibit 1). We now see 2.7% growth over 2023 (down 0.3%) due to traction from higher rates and higher inflation.

While RBA policy looks set to remain reactive, ongoing upside surprises on economic data relative to the Bank's forecasts should challenge this stance. We see the RBA raising rates to 0.5% in 4Q 2022. We expect core inflation close to the mid-part of the RBA 2-3% target band by mid-22 and for unemployment to reach 4% by the end of 2022 due to a slow and uneven resumption of labour supply following the reopening of borders. Wages growth is likely to be moving towards 3% by the end of 22. Risk is for an earlier move after the election if targets are met sooner. We see cash rates at 1.50% by the end 2023.

Fiscal policy should consolidate modestly over 2022, but a Federal election that has to be held by late May heightens political risk and might mean fiscal policy remains expansive for longer. The impact of higher rates should be limited as policy will still be accommodative while household consumption should drive growth due to income growth from a strong labour market, running down a high savings and wealth effects. There is more of a risk that inflation might crimp spending in 2H 2022.

Exhibit 18: Quarterly GDP profile versus trend
Back to trend growth by mid-2022



Source: ABS

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Exhibit 19: Key macro forecasts
Above-trend growth and higher inflation in 2022

Australia	2021F	2022F	2023F
GDP (% yoy)	3.8	4.0	2.7
CPI Headline (% yoy)	2.7	2.7	2.5
CPI core (% yoy)	1.8	2.4	2.4
Policy Rate (end of period)	0.1	0.5	1.5
Unemployment rate (end %)	5	3.8	4.3

Source: BofA Global Research

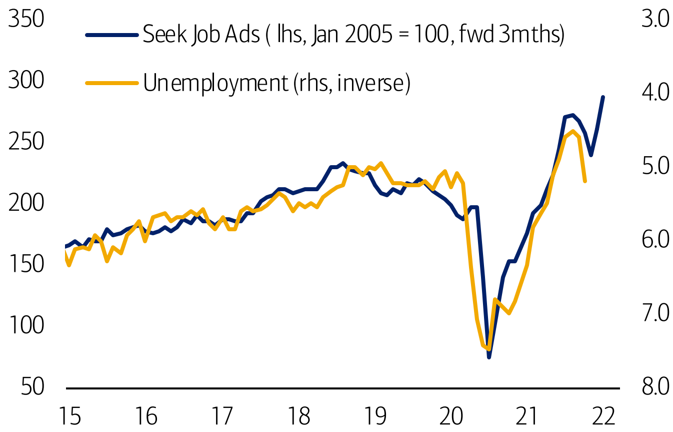
BofA GLOBAL RESEARCH

Inflation within target over the forecasts

While we've had an above consensus view on inflation for some time (See: Transition to more sustained inflation 08 September 2021) there are also upside risks. Core inflation is already back in the RBA's 2-3% target band for the first time since 2016 despite half the country being in lockdown. The RBA's previous forecasts had not expected this until the end of 2023 and the erosion of credibility in guidance has already lead to the disorderly unwind of yield targeting: A reset for RBA policy guidance 02 November 2021.

With forward indicators of the labour market pointing to a notably strong rebound from lock downs (Exhibit 3), the unwinding of government subsidies put in place in 2020 will mean both domestic and imported global inflation will push core inflation to the middle of the RBA band in 2022. Business costs are rising sharply (Exhibit 4). A shift to more sustainable energy will add to investment in 2022, but could also have price impacts.

Exhibit 20: Labour market strength ahead despite lockdown impact
Surge in vacancies & slow increase in supply points to lower unemployment



Source: SEEK, ABS

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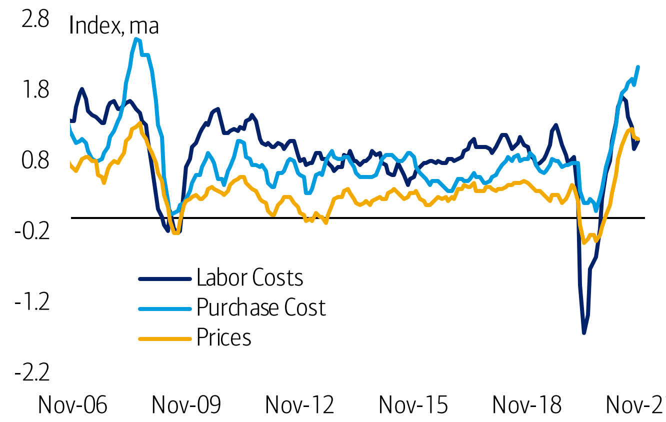
Exhibit 21: Business surveyed pipeline costs are rising
Labor costs should rise after the impact of lockdowns



Source: NAB, Macrobond

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RBA Tapering and housing

If the surge in activity after the reopening is sustained over the AU summer, as looks likely, the RBA can easily accelerate the tapering of the bond purchasing program in a review to be held in February – either by cutting the current A$4bn per week pace in half or ending the program that would open the way to RBA to lift the cash rate later in the year. With short-term market rates moving higher after the end of yield targeting, the end of QE means longer-term market rates should also rise.

So financial conditions should be tightening to take some of the steam out of the booming housing market where house prices across the country have been rising at 20%YoY and 30% in Sydney. An eventual lift in the cash rate and transmission to floating rate mortgages will have a bigger impact on 2023 growth. Macro prudential measures are likely to be marginal and incremental before then. Taking the cash rate to 1.50% by the end of 2023 will still leave it below our estimate of a neutral rate around 2.0-2.5%. Note there is likely to be a review of the RBA policy framework later in 2022.

Risks and structural change

We see a headwind from slower growth in China via the external accounts and spill over into business investment. Lower export volumes of bulk exports such as iron ore should see a -0.8% drag on growth in 2022. Iron ore prices would have to fall below current government assumptions of US$55/tonne to impact fiscal policy support for the economy ($90 current). The growth in exports of metals used in sustainable energy is rising and the government is forecasting higher earnings from energy exports relative to iron ore in FY2022-23. Greater reliance on carbon exports presents structural challenges, but is a longer-term issue (Australia's carbon transition 13 August 2021).

Domestic risks are centred on election uncertainty, a possible early slowing of housing due to over-heating and the impact of higher inflation on private spending and broader growth. This could threaten the outlook for household consumption later in 2022. We see more traction from higher rates in 2023, but high household debt and weaker housing argues for a modest tightening cycle. Data on the labour force and wages early in 2022 will be critical to assess the momentum in these factors if our assumption of a slow and gradual increase in labour supply after border reopening is correct.

China

Helen Qiao
Merrill Lynch (Hong Kong)

Miao Ouyang
Merrill Lynch (Hong Kong)

Xiaoqing Pi
Merrill Lynch (Hong Kong)

Ample room for policy easing offers hope for stabilization

We maintain our below-consensus growth forecasts for China at 7.7% and 4.0% in 2021 and 2022 respectively (Exhibit 22). While market consensus has shifted down to 5.4% yoy for 2022, well below the 6.7% average annual growth in 2015 – 2019, we think the hurdle of keeping growth above 5% next year is quite high.

Despite some early signs of policy easing, we continue to see stiff headwinds on domestic demand growth in 2022, especially against a higher base from 1H21. Very weak investment momentum coupled with sluggish credit expansion suggests the macro outlook is still far from being safe and sound yet. We believe the potential rebound in sequential growth from the lowest level in 3Q21 will be more shallow than market expects, especially given the time it takes for more easing measures to be deployed.

Macro policy focus to shift to demand stabilization

In many economies, COVID-related supply constraints and labor shortages turned out to be major roadblocks for growth in recent months. China seems to be an exception. After the economy took a hit from the widespread power crunch in Sep, top-down policy intervention boosted coal supply notably, which is expected to lower the need for power rationing and production suspension.

Consequently, the key challenge for macro stability is shifting to demand weakness. Since 2Q21, domestic demand growth saw a broad-based decline. Property and infrastructure fixed asset investment (FAI) growth dropped into negative territory (Exhibit 23). In addition, the consumption rebound turned out to be short-lived, not the least due to headwinds from 4 waves of outbreaks in the last 6 months.

Property market and credit expansion is the key

In our view, the hope for demand stabilization hinges on effective policy easing to stabilize property market and reboot credit expansion:

Property: We have long argued for an immediate relaxation of credit controls on property sector since June. In late-Sep, the central bank and banking regulator conducted window guidance on commercial banks to relax the tight credit control on mortgage and developer loans. However, the subsequent acceleration of mortgage loans was more than offset by local governments tightening the grip on private developers' pre-sale receipts. On a net basis, private developers' liquidity conditions tightened further, as more funds are locked down in escrow accounts, hurting the ability of debt repayment when refinancing access is impaired. Meanwhile, the announcement of a near-term expansion of the property tax pilot program kept potential buyers in suspense, weighing on property sales.

Credit expansion: The PBoC's assurance of stable credit expansion didn't seem to have boosted total social financing growth from the 15-year record low level at 10.0% yoy in Sep or Oct. As banks are turning more risk averse, especially on property developers, effective credit demand remains weak.

Why policy easing is neither timely nor effective

It is both surprising and perplexing to see the delay in policy responses so far. As an expert of countercyclical policy, the current administration should have expected slower growth well before the evident sharp slowdown in 4Q. But why didn't they move earlier?

Arguably, policymakers rolled out a RRR (reserve requirement ratio) cut in mid-July, and called for easing on infrastructure funding on the quarterly Politburo meeting at the end of July. However, such measures by themselves were clearly insufficient to stabilize credit growth or investment momentum.

What is truly striking is the lack of follow-up measures to stabilize growth. In our view, there are a few **technical drivers** that could partly explain the policy inaction, including: (1) **policy complacency** due to strong 1H21 growth and effective (albeit costly) pandemic control; (2) **very low risk tolerance,** esp. for COVID and property; (3) **policy inertia before the 20th CPC,** which features reshuffles in key government positions. As macro instability risks rise further, these factors will likely diminish over time.

Exhibit 22: Summary of key macro data and forecasts
We maintain our below-consensus growth forecasts for China at 7.7% and 4.0% in 2021 and 2022 respectively

		2019	2020	2021F	2022F	2023F
GDP by expenditure						
Real GDP Growth	% yoy	6.0	2.3	7.7	4.0	5.3
Final Consumption Expenditure	% yoy	6.4	-0.9	5.6	5.0	5.9
Gross Capital Formation	% yoy	3.9	5.0	5.7	2.5	5.1
Contribution to GDP Growth						
Net Exports	pp	0.8	0.6	0.5	0.3	-0.1
Major activity indicators						
Industrial Production	% yoy	5.7	2.8	9.3	5.2	5.0
Fixed Asset Investment	% yoy	5.4	2.9	4.3	3.6	5.8
Retail Sales	% yoy	8.0	-3.9	12.6	5.5	6.1
Exports of Goods	% yoy	0.5	3.6	28.9	6.0	7.0
Imports of Goods	% yoy	-2.7	-0.6	27.3	5.5	8.0
Trade Balance	US$ bn	421	524	709	765	791
Current Account	% GDP	0.7	1.9	2.2	1.9	1.6
Key price and policy indicators						
CPI	% yoy	2.9	2.5	0.9	2.0	1.7
PPI	% yoy	-0.3	-1.8	8.0	2.4	1.0
1y Loan Prime Rate	%, year-end	4.15	3.85	3.85	3.60	3.60
USD/CNY	year-end	6.96	6.53	6.45	6.60	6.20

Source: BofA Global Research, CEIC, Bloomberg

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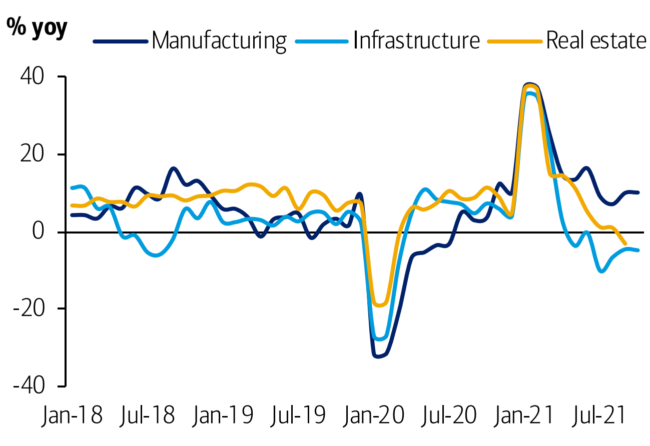
Exhibit 23: FAI sector breakdown
Property and infrastructure FAI contracted



Source: BofA Global Research, CEIC, NBS

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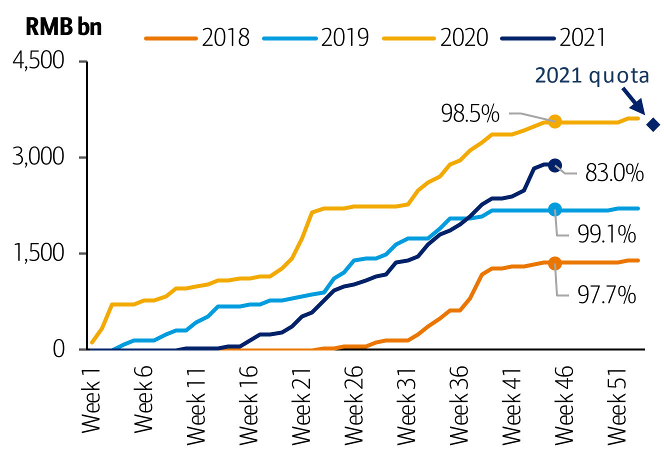
Exhibit 24: Weekly LGSB issuance
YTD LGSB issuance still lagged, only reaching 83% of annual target



Source: Wind, MoF

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Policy priority shifted towards long-term social goals

On the other hand, there may be a more important **structural driver** for delayed policy easing – policymakers deliberately shifting policy priority from short-term growth stability towards long-term social goals (e.g., common prosperity, decarbonization, and reducing three largest burdens on households from property, education, and healthcare).

If this is the case, such a shift means Chinese policymakers may have a much higher pain tolerance level for lower growth and for much longer than during previous cycles in the past two decades. In addition, another reason to be concerned about short-term growth outlook is while these long-term goals are seen to be ultimately positive on trend growth, an abrupt and decisive change in tack implies stiffer headwinds on growth.

Last but not the least, it also means China would be under pressure to rotate its growth drivers from the old engines (especially the property sector) to new engines (e.g., renewable energy, electrical vehicles, 5G, etc.) in time to prevent a more sustainable weakening in its trend growth, which could be challenging in the near term.

Further policy easing still warranted

Even with such a policy priority shift taking place, downward pressure on domestic demand still warrants further policy easing. We expect another year of fiscal and monetary easing in China to support demand side recovery.

- **Boosting consumer confidence** via (1) targeted relending and interest repayment extension for SMEs to help stabilize employment; (2) issuance of consumption vouchers by local governments; and (3) less strict control policies for tracing COVID after reaching herd immunity.

- **Funding support for infrastructure investment:** The pace of LGSB (local government special-purpose bond) issuance is still behind schedule, reaching only 83% of the annual target ytd). With a drop in local government land sales revenue, proactive fiscal expansion in 2022 is needed to support infrastructure investment. We expect fiscal deficit to remain >3%, and LGSB quota to be around RMB4tn (vs. RMB3.65tn in 2021), front-loaded early in the year to support the recovery on infrastructure investment

- **Relaxing credit conditions for property sector, possibly from social housing:** Some early signs of relaxation on property sector financing have emerged. Oct new mortgage loans saw mom improvement, and a number of SOE developers have re-launched financing channels in the onshore bond market since mid-Nov. We expect further relaxations in credit conditions, such as designated funding assistance for private developers and credit support on social housing and urban renewals.

- **More monetary easing:** Unlike other major central banks, the PBoC has been cautious and not eased much since the pandemic, which leaves ample room for monetary easing if necessary. That said, the PBoC seems to be increasingly leaning towards quantity-based adjustment (e.g., MLF and relending) instead of price-based measures. While we still believe the PBoC should cut policy rates and RRR to lower funding costs as soon as possible, we now expect only 25bp cut in 1yr LPR in 1H22.

Balanced risks on either side of our forecasts

We see two potential positive catalysts in the near term: (1) **a step-up in policy easing measures**, if the upcoming Central Economic Work Conference (CEWC) in mid-Dec strikes a more dovish tone and highlights the need for growth stabilization; (2) **an improvement in US-China relationship** leading to removal of some tariffs, following the climate change agreement at COP26 summit and Biden-Xi meeting on Nov 16.

Meanwhile, we also see downside risks from various aspects, including: (1) **property market turmoil**, if Chinese policymakers fail to contain the spillover risks; (2) **higher headline CPI inflation** due to rising food and fuel prices, which may limit the scope of monetary easing; and (3) **surprise in policy tightening** such as further deleveraging in LGFVs (local government funding vehicles).

India

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With growth comes inflation & rate hikes

Real GDP growth to stay strong at 8.2% yoy in FY23

After the deep recession in FY21, expectations were high for growth to rebound strongly in FY22. But the second wave in early 2021 again dented the growth path for the Indian economy. That said, favorable base effects and a late (but sharp) pick-up in activity should still take real GDP growth from -7.3% yoy in FY21 to an estimated 9.3% yoy in FY22. Moving on to FY23, while sequential growth is estimated to be strong, year-ago growth rates would look less encouraging as favorable base effects fade (except for the June quarter). We forecast FY23 real GDP growth at 8.2% yoy (Exhibit 1) and see real GVA growth at 7% yoy. On the expenditure front, consumption is likely to drive growth, paving way for higher investment demand in FY24. As for gross value added (GVA), while services (barring public services) are expected to do relatively better, manufacturing is likely to see slower growth. Meanwhile, growth in agriculture is expected to remain largely unchanged.

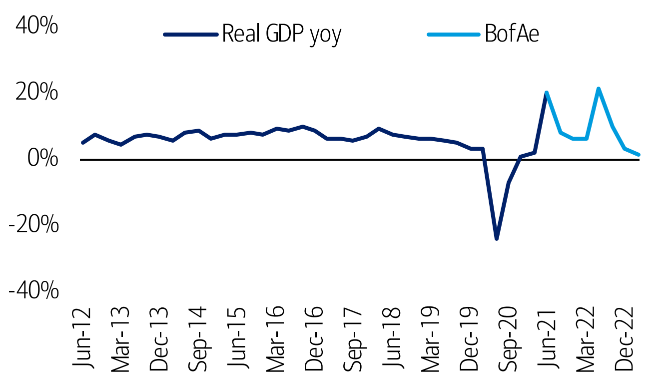
CPI inflation to rise to 5.6% on average in FY23

Supply shortages and data collection issues, which drove CPI inflation to an average 6.2% in FY21, also spilled over to 1QFY22. As we had argued back then, still-weak demand and incomplete pass through from WPI took CPI inflation lower. More recently, inflation is again on the rise but we still see it averaging 5.3% yoy in FY22. In FY23, inflation is expected to rise further to an average 5.6% (Exhibit 2), as demand recovers and global commodity prices stay elevated or rise further (e.g. oil). Core CPI inflation, which has been sticky at around 5.5-6.0%, is likely to exert upward pressure on headline, even as food inflation stays largely contained. The recent cut in oil taxes offers some comfort to inflation trajectory in the coming months, but some upward resetting of menu costs amidst rising raw material prices cannot be ruled out as growth revives.

RBI to hike policy repo rate by 100bp in FY23

Given our growth-inflation estimates, we see the RBI Monetary Policy Committee (MPC) hiking policy repo rate by 100bp in FY23, starting in June. While CPI inflation is still expected to rise only modestly, the MPC is likely to re-focus on the 4% target, rather than the 2-6% range that they referred to as a flexible inflation targeting central bank in support of growth during the last 20 months. To prepare for the policy rate hike, we expect the reverse repo rate, which had become the effective rate given flush liquidity conditions, to be raised by 40bp in Feb'22 restoring a symmetric policy corridor. This would likely be followed by a change in monetary policy stance from 'accommodative' to

Exhibit 25: Real GDP yoy growth trajectory
See strong growth in FY23 with real GDP averaging 8.2% yoy



Source: MOSPI

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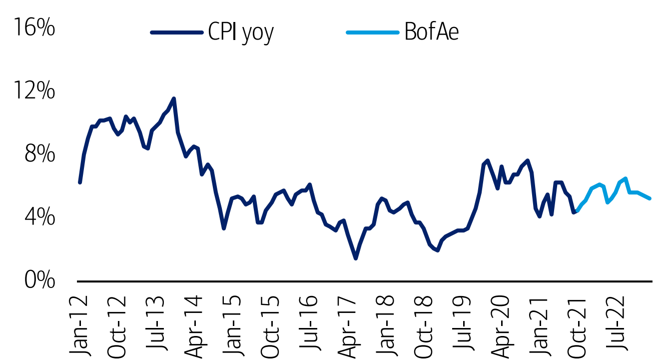
Exhibit 26: Monthly CPI inflation yoy trajectory
See CPI inflation rise modestly to average 5.6% yoy in FY23



Source: MOSPI

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'neutral' in Apr, before the policy repo rate is hiked in Jun. Thereafter, we see the RBI MPC move to 'tightening' stance in Aug'22 and raise repo rate by 25bp in the next three policy meetings until Feb'23, taking the policy repo rate to 5% at the end of FY23 and 5.5% by end of CY23. This gradual and calibrated normalization path is consistent with the current intentions to keep the hiking cycle non-disruptive, but the RBI MPC could quicken the pace if inflation remains close to the upper end of the 2-6% range.

Fiscal consolidation and contained CAD to preserve stability

As growth recovers, fiscal deficit is also likely to fall. We see centre's fiscal deficit in FY23 moderate to 5.8% of GDP from an estimated 6.8% in FY22. The Rs 5 and Rs 10 per litre cut in excise duty on petrol and diesel are likely to cost ~INR 1trn to the public exchequer, but we expect delayed divestment inflows to make up for this lost indirect tax revenue. At the same time, production driven excise collection and, to some extent, direct tax revenues are expected to improve (though marginally vs FY22) inFY23. We don't see any major increase in revenue expenditure in FY23 and increase in capex is also expected to be modest. In terms of funding the fiscal, India's highly-anticipated inclusion in global bond indices can prove to be a game changer.

On the external front, as oil is expected to average US$85/bbl in CY22, we see current deficit rising from US$40bn/1.3% of GDP in FY22 to US$65bn/2% of GDP in FY23. Even with the higher current account deficit (CAD), we don't envisage any serious concerns on India's external position as the deficit remains well below the 2.5% of GDP threshold. In addition, robust capital inflows should ensure a balance of payments (BoP) surplus in FY23 as well.

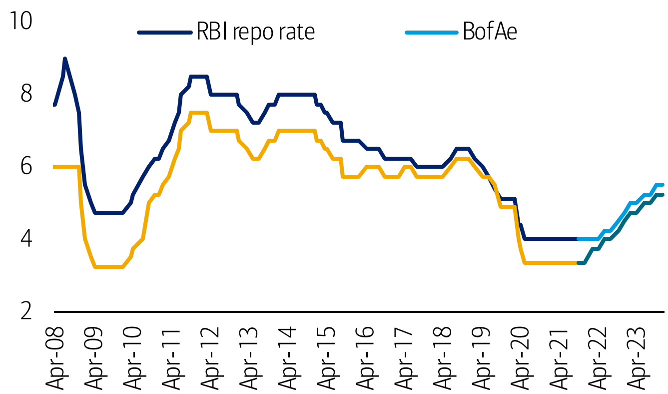
In this context, we see macro stability being well preserved in FY23 for India. Steady growth recovery, modest increase in CPI inflation, prudent RBI policy path, gradual fiscal consolidation and well-in check current account deficit should secure the macro-prudential gains achieved though close fiscal and monetary policy coordination during the pandemic period.

Key risks: Virus, vaccine and global commodity prices

While the overall virus situation looks under control, slowing pace of vaccination is a key risk to watch out for. Daily run rate of doses has also fallen to 4.1mn/day in Nov so far vs a record 7.8mn/day in Sep (Exhibit 4). At this run rate, India should be able to vaccinate 70% of her total population with the first dose by end-Dec. Currently, 56% India's total population has gotten their first dose and 28% are fully vaccinated. Rising global commodity prices are another key risk to our inflation (and therefore RBI's policy path). Should global prices continue to rise persistently, a sharper increase in CPI and a higher pass-through from WPI to CPI needs close attention. Should this materialize, RBI MPC may resort to earlier and/or quicker policy repo rate hikes.

Exhibit 27: RBI policy rate path

Expect RBI MPC to gradually take repo rate to 5% by end FY23



Source: RBI

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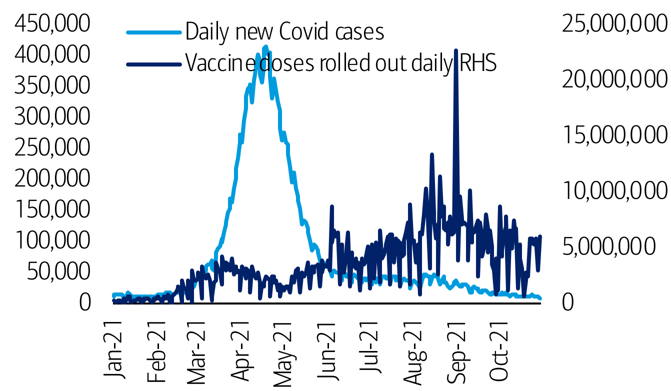
Exhibit 28: Covid-19 daily cases and daily vaccination

Daily cases under control now, but slow pace of vaccination is a key risk



Source: CEIC, ICMR, MoHFW

BofA GLOBAL RESEARCH

Korea

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Political transition, growth normalization

Growth normalization to 3.1% amid year of presidential election

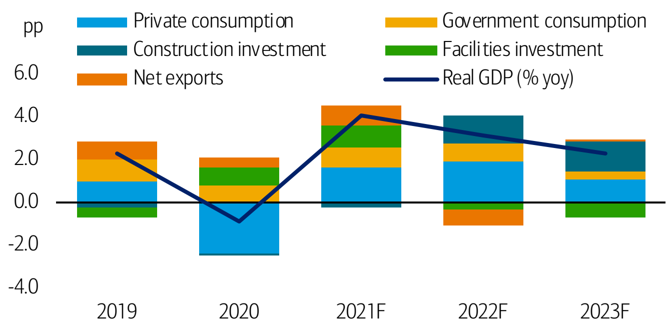
Korea's 2022 GDP growth is set to rise above trend, while normalizing down from 2021. While we expect Korea to continue a resilient turnaround from the pandemic-induced recession for the second year, the momentum is likely to gradually stabilize. With solid consumption rebounding anticipated from 4Q21 onward through 2022, we expect the economy to grow 3.1% in 2022 vs 4.1% in 2021 (mark-to-marking from 4.3%) and stabilize to 2.3% in 2021, closer to potential growth rate.

In particular, we remain constructive on the consumption-led growth story. We have revised up private consumption growth forecast to 4.1% from 3.8% for 2022, newly penciling in post-election stimulus to boost sentiment and consumption. Coupled with the adoption of the "living with COVID" strategy, easing mobility and business hour restrictions, and further opening up of the border, we expect services consumption to offset waning external demand and facilities investment momentum.

Export outlook however remains clouded. While the stabilization in global manufacturing activities will still keep the overall demand relatively stable during 1H22, we see a lack of renewed catalyst for global demand in the latter half of the year when pent-up demand loses stream and previously elevated level of optimism led by fiscal stimulus dwindles on tightening monetary environment globally. Moreover, on top of major slowdown in industrial activities in China, we now add a new source of headwind from the growth slowdown in the US and potential negative ripple effect onto overall global demand.

Meanwhile, fresh expectations are likely to build up ahead of the presidential election, scheduled for 9 March 2022. The top-two candidates have now been finalized. Policy uncertainty associated with the election could persist through early 2022. Nonetheless, we expect sentiment, especially among households, to improve after the election as we have observed in the past four elections. Fresh expectations and support for the new administration will likely boost consumption. Firms however are likely to delay capex decisions and remain cautious, especially in the backdrop of tighter monetary policy.

Exhibit 29: Our annual GDP growth forecast by expenditure account
Korea's growth momentum likely to gradually dwindle



Source: BofA Global Research estimate, Bank of Korea

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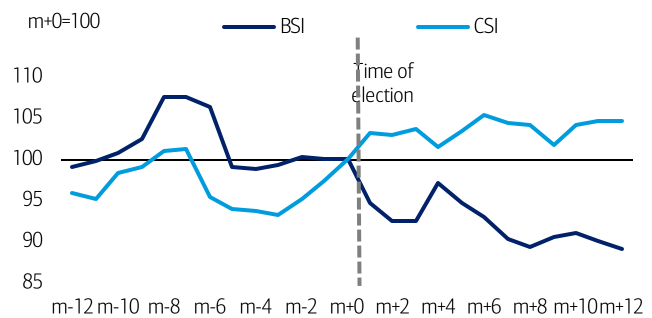
Exhibit 30: Sentiment analysis before and after election in past 20 years
Consumer sentiment started to rise visibly after the election



Source: BofA Global Research, Bank of Korea

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Inflation: Headline price level likely to fall back below target

We forecast CPI inflation will fall back below the Bank of Korea (BoK)'s target in 2022. We now see the headline inflation rising 2.2% from 2.0% in 2021 due to mark-to-marking, while we continue to expect price pressure to stabilize next year to 1.8%. Although demand-driven price pressure is expected to mount in 1H22 as the economy reopens and sentiment improves before it stabilizes in 2H22, we see supply-side pressure weakening due to high base and policy intervention (fuel tax cut effective until April 2022). Moreover, tighter monetary policy and signs of housing market stabilization pose offsetting factors to domestic price rise. Nevertheless, uncertainty around fiscal policy, dissipation of downward drag from administered prices and weaker KRW should provide mild support to the headline.

Policy: BoK on relatively benign rate hike cycle, fiscal stimulus post-election

In the backdrop of growth stabilization, we expect relatively benign rate hike cycle by the BoK vs this year. After delivering two rate hikes (Aug and Nov 2021), we see the members pausing and monitoring the impact on the economy. However, with determination to normalize the policy rate back to the pandemic-level (1.25%), we see the MPC pushing through another hike in 2Q22 after the election when policy-related uncertainties are removed. Afterwards, we now pencil in one more hike in 2023 as the Fed kicks off an aggressive hiking cycle, aimed to manage widening rate differential.

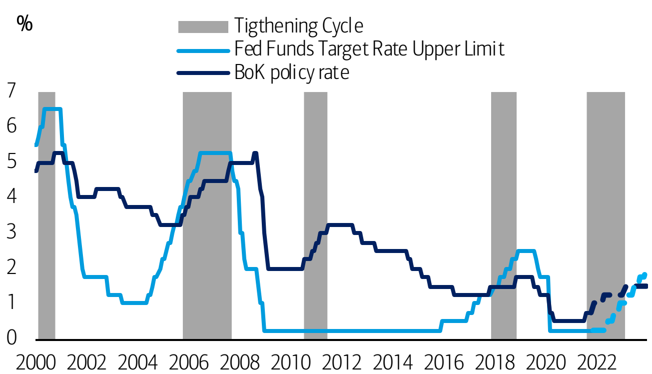
On the fiscal front, we expect the new government to execute supplementary budget to boost sentiment and consumption. Upon inauguration in May, we expect the President to consolidate sentiment via stimulus. Depending on who takes the office, we see the size and magnitude, whether targeted or universal, of stimulus varying.

Risk balance tilted to downside

Uncertainty looks tilted to the downside. Uncertainty looks high around persisting supply disruptions. The Fed's rapid hiking cycle and its spillover effect onto other DM and EM central banks likely pose uncertainty as well. Larger China deceleration could dim the export outlook even further. Domestically, uncertainty remains high with the BoK Governor replacement in March, same month as the election. Our consumption-led growth story would face a hurdle in case the bank pursues a faster hiking cycle.

Exhibit 31: BoK and Fed policy rate trajectory

We expect the BoK to pursue a more benign hiking cycle than the Fed



Source: BofA Global Research estimates, BoK, Fed

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Table 1: Major macro forecasts

Korean economy will gradually wane to potential growth

Korea	2021F	2022F	2023F
Real GDP (% yoy)	4.1%	3.1%	2.3%
CPI (% yoy)	2.1%	1.8%	1.6%
Policy Rate (end of period)	1.00%	1.25%	1.50%
Fiscal Bal (%/GDP)	-4.0%	-4.3%	-4.7%
CurAct Bal (%/GDP)	4.4%	3.9%	3.4%

Source: BofA Global Research

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ASEAN

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The recovery extends into 2022

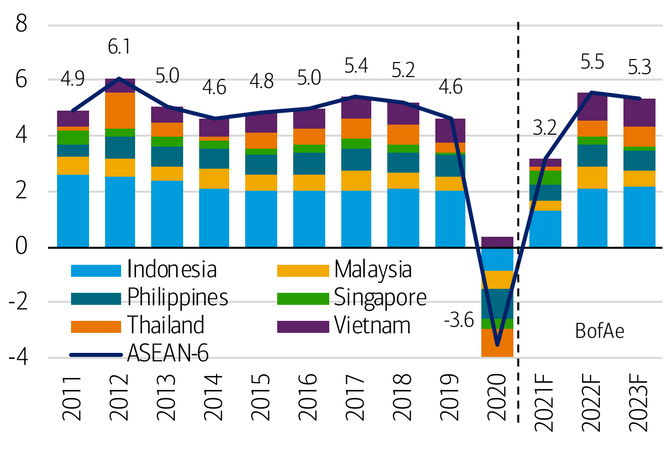
2022: Higher growth & inflation to bring policy normalization

ASEAN's 2021 recovery from the Covid pandemic suffered a setback as the Delta wave resulted in record high cases and deaths in several countries. Restrictions on social and economic activities, and in some cases even nationwide lockdowns, were re-imposed to alleviate the stress on the healthcare system. This caused the recovery to be even more uneven than we had envisaged, with domestic demand and consumer-facing activities suffering fresh blows while the external sectors outperformed. The economic damage was severe, with ASEAN-6 GDP now on track to grow just over 3% this year vs. the above-potential 5.8% we had forecasted a year ago. Output is still below 2019 levels for the region as a whole, due to the muted recoveries in Thailand, Philippines and Malaysia.

With significant progress on the vaccination front and a shift to 'living with Covid' strategy, we expect domestic demand (especially private consumption) to rebound strongly in 2022. We see further relaxations of restrictions into 2022, with future surges likely to be countered with localized and targeted measures. This should allow for a gradual, but more sustained, recovery in the consumer-facing sectors and also help ease disruptions in manufacturing and construction sectors. On the other hand, international tourism is only expected to pick up meaningfully in 2H22 and into 2023, but Singapore could buck the trend with quarantine-free travel lanes with several key markets. Fiscal deficits are expected to be trimmed only gradually in most of ASEAN, ensuring continued policy support for households and firms in the worst-hit sectors.

Even as domestic demand rebounds, support from exports is likely to come off slightly as global growth cycle matures and the demand recovery in China remains weak. The trade-reliant ASEAN economies are clearly more at risk, but some of this downside for Indonesia and Malaysia could be cushioned if global commodity prices stay elevated. The rest of ASEAN tends to lose when energy prices rise, given sizeable net-imports. All in, we expect strongly above-trend growth in Malaysia (7.0%) and Singapore (4.0%), slightly above-trend in the Philippines (7.2%) and Thailand (3.9%) and close to trend in Indonesia (5.0%) and Vietnam (7.2%). GDP will cross pre-Covid levels in most countries (except Thailand), but remain 7-15% below pre-Covid trend (except Singapore).

Exhibit 32: ASEAN-6 GDP growth and its drivers (% yoy)
After a partial recovery in 2021, growth is expected to improve into 2022



Source: BofA Global Research estimates, CEIC

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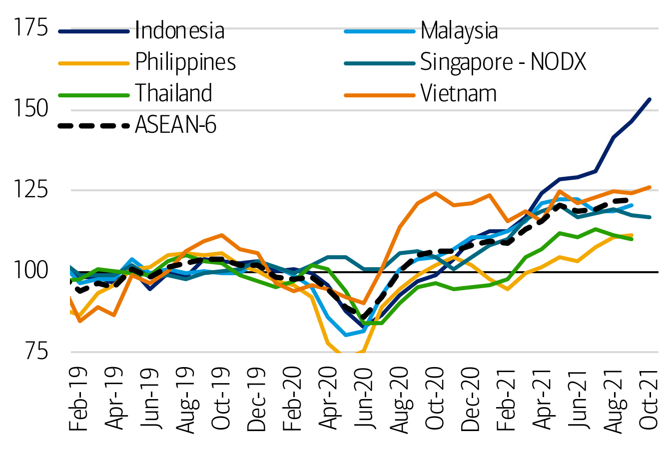
Exhibit 33: Goods exports across ASEAN (Index, 2019=100, 3MMA)
Exports have recovered strongly, esp. in Indonesia in recent months



Source: BofA Global Research estimates, CEIC, Haver

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With the exception of Indonesia and Vietnam, consumer price inflation has surprised on the upside this year even as it has generally stayed within the usual tolerance levels. Despite policy efforts to cushion the rise in global energy prices, retail prices of fuel and household electricity tariffs have gone up to some extent in most countries except in Indonesia. Food inflation has also risen in tandem with global trends, with supply disruption and adverse weather also contributing in the case of Thailand and Philippines. Underlying inflation, excluding food & energy, has in general remained benign, while the region has been mostly insulated from large supply-related price increases.

We now see inflation averaging 2.2% in ASEAN this year, but forecast it to rise to a ten-year high of 2.7% in 2022. The biggest increases are seen in Vietnam and Indonesia, largely due to the weaker-than-expected outturns this year and also due to the delayed recovery in domestic demand in both. We also expect inflation to rise in Thailand to an average of 2% next year and a slightly higher 2.3% in Singapore (with policy-relevant Core also rising to 1.8%), alongside the gradual absorption of excess capacity and also higher global energy prices. On the other hand, headline inflation is expected to ease back to the target range in the Philippines and also come off slightly in Malaysia. Any adjustments to retail fuel price caps and electricity tariffs will exert further upward pressure on inflation, especially in in Malaysia and Indonesia.

Policy: Gradual normalization is our baseline

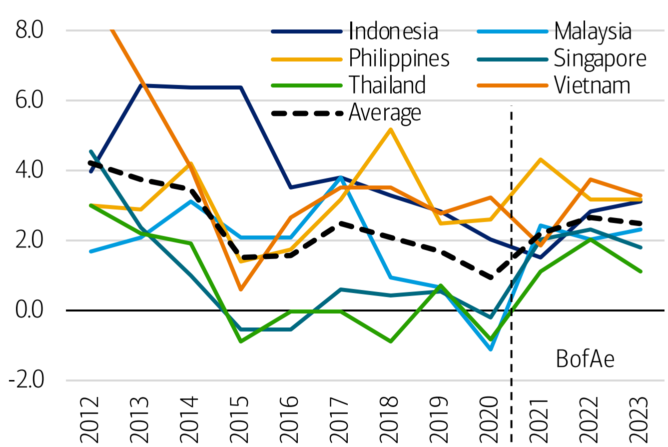
2021 was a relatively stable year for monetary policy, with the exception of a 25bp cut in Feb by BI and an unexpectedly early tightening by MAS in Oct, as ASEAN central banks had little reason to move with a subdued recovery and manageable inflation. With the anticipated recovery and higher inflation next year, we expect all ASEAN central banks to tighten policy settings. In our baseline scenario where external pressures from the faster Fed Taper and quicker hikes are under control, policy normalization in ASEAN is likely to proceed in a gradual fashion. Central banks in Thailand and the Philippines, where output gaps are the most negative even into 2022, could even lag the US Fed. However, risks of an earlier and faster tightening cycle cannot be ruled out.

Risks are skewed towards softer growth and higher inflation

On balance, growth risks are to the downside and could materialize if domestic demand is held by the emergence of new Covid variants or due to deeper scarring effects. External risks are also present, notably from a sharper than expected slowdown in China and heightened financial market volatility. Inflation could rise faster than expected if fuel price caps are adjusted or if supply disruptions still persist.

Exhibit 34: ASEAN-6 headline inflation & forecasts (% yoy)

Inflation is expected to rise in most ASEAN economies in 2022



Source: BofA Global Research estimates, CEIC

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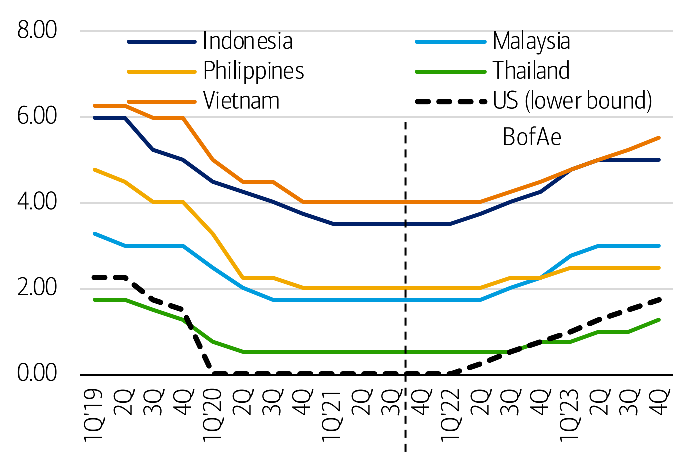
Exhibit 35: Central bank policy rates (%)

ASEAN central banks are likely to normalize policy rates over 2022-23



Source: BofA Global Research estimates, CEIC

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EEMEA

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It's getting interesting

2022 is likely to see lower growth and lower – but sticky – inflation across the region. Most central banks will continue to tighten, including in the CEE countries, Israel and South Africa. Russia, which frontloaded the hikes in 2021, is likely to start an easing cycle. Turkey is particularly exposed to a global backdrop of higher rates and higher oil prices, especially after having cut rates lately. The Gulf Cooperation Council (GCC) countries will benefit from high oil prices.

Russia: beginning of the easing cycle

2022 should feature several key policy turns. First, in 1Q22 the CBR should reach the peak of its tightening cycle, which should push the market to evaluate the timing of the eventual start of easing. We expect the CBR to start cutting rates from 3Q22 to 7.25% in 2022. The CBR will also complete its monetary policy review in 2Q22 with a potential cut in the 4% inflation target, giving an indication of the terminal rate after easing.

Secondly, the government will also start spending from the National Wellbeing Fund with some RUB2500bn ($35bn or 2% of GDP) earmarked for the next 3Y. This may support growth, but also cut into daily FX purchases by the MinFin, which would increase the beta of RUB to crude oil. The expected easing cycle should be protected from global volatility by high oil prices, which should help to prevent FX pass-through to inflation.

Geopolitics still the main risk

The US-Russia relationship remains the main risk. While there have been some positive developments lately, major potential flashpoints remain. One is more sanctions related to elections, currently being pushed by US Congress; tensions can easily heat up again ahead of midterm US elections in November. Others are the gas supplies to Europe as well as the security situations around Belarus and Ukraine.

With the next Federal elections set for 2024, domestic policy should be less of concern for the market from a political risk or policy change perspective. However, the year may see intensified discussions on the outcome of 2024 elections, where the incumbent has effectively created a legal framework for a controlled political transition, but also retains the option to stay in the position for longer.

CIS: doing the homework

Ukraine's progress with the extended SBA as well as its plans for its rollover in 2H22 are set to remain the key driver for Ukrainian assets. However, the market may also start to see benefits of fiscal consolidation with reduced fiscal financing needs. In contrast, Ukraine may see escalating balance of payments and fiscal pressures in 2Q22 if EU gas prices remain elevated. Belarus is expected to complete its constitutional reform, which may help to reduce geopolitical risks in the event of the start of political transition.

SSA: in a tight spot

2022 brings a shift for sub-Saharan Africa (SSA) countries towards tighter monetary policy conditions. Real rates are negative in Nigeria and South Africa. On the front foot will be the SARB, which we expect to hike by a cumulative 125 basis points in 2022. For other SSA central banks the path is less certain. There are further considerations, such as supporting growth and targeting exchange rates. We are likely to see Kenya raising the policy rate in response to higher inflation – a culmination of higher food prices as a consequence of the drought and the second-round effects of higher energy prices on rising core inflation in 2022.

Growth: leaders vs laggards

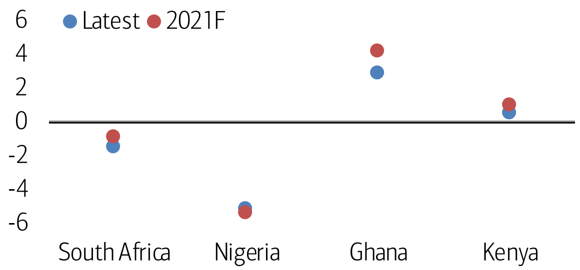
Ghana and Kenya are likely to return to normal growth levels of 5-6% while South Africa and Nigeria will stay at around 2%. Slow structural reforms in both Nigeria and South Africa could inhibit faster growth. Temporarily, the slow reforms could be overshadowed by positive terms of trade from the commodity cycle in both countries and over perform our base expectations, unless China slowdown transmits to lower commodity prices. For now, the beat goes on.

Political risk could weaken fiscal reform

Elections in Kenya in August 2022 are likely to delay fiscal adjustment due to expenditure pressures. In South Africa, fiscal consolidation based on expenditure adjustment could be delayed due to calls for increased social grants and wage agreements likely to settle at higher levels than currently factored into the fiscal framework, especially against the backdrop of higher mining tax revenues, an internal African National Congress (ANC) elective conference in December 2022, and coalition politics at the local government level.

Exhibit 36: Real policy rate

Negative real rates in South Africa likely to close



Source: Bloomberg, BofA Global Research

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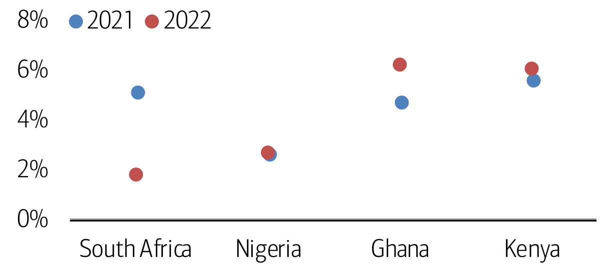
Exhibit 37: Real growth outlook

Kenya and Ghana on a high while Nigeria and South Africa slow



Source: IMFWEO, BofA Global Research

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Turkey: new policy, new risks

Encouraged by the strong increase in exports due to global recovery, policy makers are trying to achieve current account correction for good. Monetary policy now targets the current account, trying to boost exports and investment by lowering rates and allowing TRY to weaken. However, weaker TRY contradicts the price stability objective and helps very little with exports once the global demand is accounted for. Since the 300bp policy cut, real deposit rates have already turned negative and commercial loan rates are decreasing fast. Loan growth is likely to accelerate in 2022 and weigh on TRY.

Giving up on price stability is costly

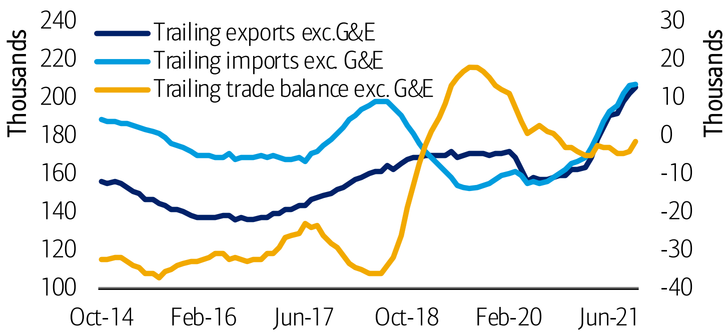
High inflation is fast eroding the purchasing power of-low income households. Policy makers are trying to alleviate the burden on households with fiscal measures such as social transfers and tax breaks. Increased long-term borrowing costs will also weigh on the budget next year. However, there is still significant fiscal space to accommodate these costs given strong budget performance this year. Elections are scheduled for June 2023, so it is likely that fiscal support measures will continue to be used until then.

Will the policy reversal everybody's waiting for come?

Upside risks to inflation will likely remain high in 1H22 due to TRY depreciation and increasing energy prices. However, temporary inflationary effects from global commodity price increases and supply bottlenecks should ease in 2H22, and risks should be more limited to domestic factors. A policy reversal at any point would lead to a quick improvement in FX and asset prices, however, but it is very hard to pinpoint the triggers for such a change given the strong and persistent political will for lower rates. In the case of an early election, which is a tail risk in our opinion, expansionary policies on both the fiscal and monetary fronts might accelerate, causing significant volatility in TRY.

Exhibit 38: 12-month trailing trade balance, export and imports excluding energy and gold (USD bn)

Trade deficit steady due to large increase in exports, limiting CA deficit despite near double-digit GDP growth



Source: Haver, BofA Global Research

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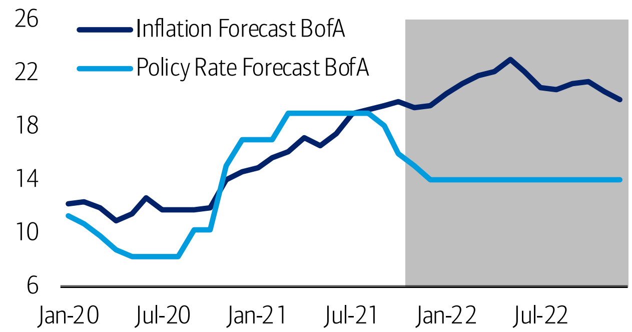
Exhibit 39: Inflation and policy rate forecasts, %

Inflation will likely remain high in 1H22 after CBT cuts another 100bp in Dec and holds in our base case scenario



Source: Haver, BofA Global Research

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MENA: the haves and the have-nots

Iran tensions key to geopolitical risk premium and OPEC+

Iran nuclear tensions are likely to remain elevated in 2022. A return to the nuclear deal appears unlikely for now as talks are expected to drag on. With the lack of progress in negotiations, it is unclear whether the US could decide to focus on enforcement of Trump-administration sanctions. Current elevated oil prices could prevent such an outcome, however. Threats of military force may be used against the backdrop of continued rapid advances in Iran's nuclear program, and could increase the regional geopolitical risk premium.

OPEC+ to walk a fine line in 2022

OPEC+'s Dec 2 meeting is likely revise the current planned pace of supply hikes. This reflects the large planned increase to production reference levels versus anticipated demand growth for 2022, according to OPEC+'s own projections. The more balanced supply/demand dynamics suggest OPEC+ could stay cautious to support high oil prices.

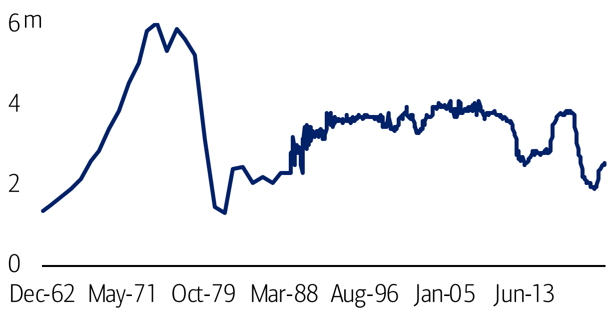
Gulf Cooperation Council (GCC) countries best placed to weather backdrop

The GCC countries are well placed to weather the backdrop on the back of high oil prices and relatively advanced Covid vaccination. These countries are likely to post relatively large current account surpluses. Fiscal deficits and funding needs are also likely to narrow materially, although there is a risk of some loosening in fiscal spending. Reform momentum in Oman and Bahrain, as well as potential GCC support to Bahrain, are likely to be key market catalysts in 2022.

Levant – North Africa: under pressure

Higher oil prices are likely to support Iraq, but this is offset by the authorities' lack of interest in engagement with the International Monetary Fund (IMF) and by political uncertainty post-elections. The stepped up access under the IMF Extended Fund Facility (EFF) program could shelter Jordan, but the authorities are likely to require continued reform momentum and strong efforts to mobilize donor financing, especially if Saudi financial support is halted. Elections in Lebanon are key to the outlook and to whether reforms could be launched to promote economic recovery and start talks with bondholders. Political volatility in Tunisia and decreasing FX reserves raise restructuring risks.

Exhibit 40: Iran oil production 1962-2021
Fate of Iran's 2022 oil production adds to supply/demand uncertain paths



Source: Haver, Bloomberg, BofA Global Research.
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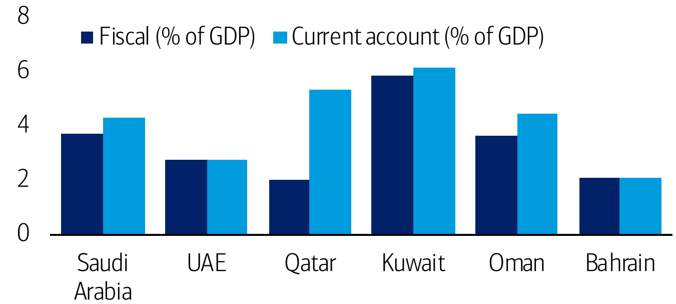
Exhibit 41: Sensitivity of GCC accounts to a US$10/bbl oil price swing
GCC countries set to benefit from high oil prices



Source: Haver, IMF, BofA Global Research.
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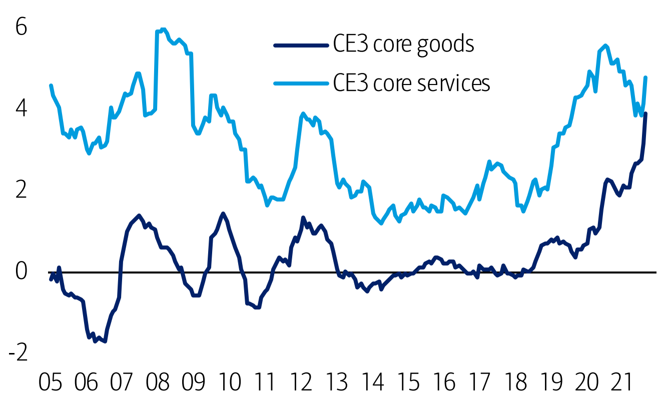
CEE and Israel: continued recovery, continued tightening

Dynamic growth will likely continue in 2022, strengthening the positive output and thus the case for central banks to remove more monetary accommodation amid substantial inflation overshooting. We look for above-potential, but sub-consensus GDP growth rates in 2022 (Czechia: 4%, Hungary: 4.8%, Poland: 4.7%, Romania: 4.7%, Israel: 5.0%). Despite supply disruptions and high commodity prices, GDP should be supported by private consumption, as households tap savings built-up over the pandemic, while also enjoying robust income growth owing to overheating labour markets. We also see an upbeat investment outlook for Central and Eastern Europe (CEE) driven by EU funds, while the recent regional political developments mean that fiscal policy will stay generally accommodative in 2022. Net exports will contribute negatively to growth until 2H 2022 due to supply constraints.

Inflation acceleration has been due to both supply and demand factors, though Israel is facing less pressure than CEE due to an appreciating currency. The latest surge in energy prices accentuates fears of second-round impacts. In CEE, the substantial CPI overshooting, 7-8% by 1Q22 vs 2-3% targeted, implies further sharp rate hikes in the coming quarter. We look for a YE2022E policy rate at 4% in Czechia, 3.90% in Hungary, and 3.50% in Poland and Romania. CEE FX appreciation would help address the external factors in CPI, but is probably only a feasible tool for the Czech central bank given high FX reserves. In Israel, the central bank's tightening has started via ILS appreciation. Rate hikes will probably begin in 2Q22 ahead of the Fed, with YE2022E likely ending at 1%.

Exhibit 42: CE3 – underlying core inflation developments*
Inflation driven in a large part by goods due to global factors, which can be addressed by strong FX



Source: Eurostat, Haver. *Simple average of HICP breakdown in Czechia, Hungary and Poland
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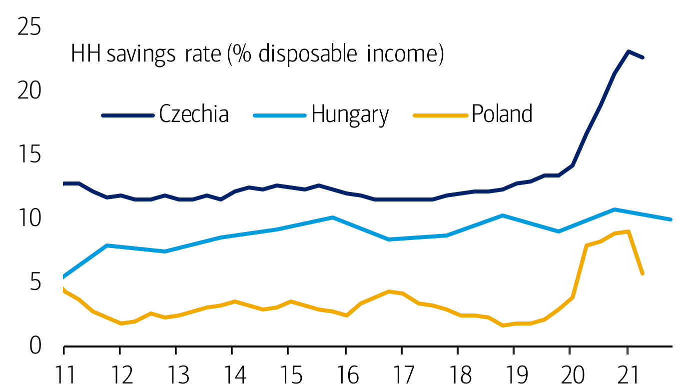
Exhibit 43: CE3 – households' savings rate
GDP will be well supported by consumption as households tap the extra savings built over the pandemic



Source: Central banks, Haver
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Brazil

David Beker >>
Merrill Lynch (Brazil)

Politics at the front seat

GDP growth back to low levels

We expect GDP growth at 1.1% in 2022 (from 4.9% expected in 2021) given rising interest rates, high inflation, political noise and input shortages. In our view, activity will face several headwinds in 2022 that will drive GDP growth below the average of post 2015-2016 recession (1.5%). An upside risk to activity is the full normalization of services sector in 2022 that accounts for around 60% of Brazilian economy.

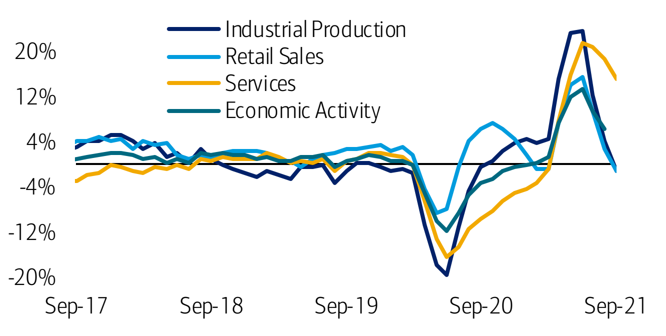
We forecast several drawbacks to main demand components in 2022. Private consumption may be challenged by falling consumer's purchase power, high consumer inflation and more restrictive credit environment amid higher interest rates. Moreover the high levels of unemployment should persist in 2022, as we forecast average unemployment rate at 11.8%, which will reduce private consumption potential ahead. Investment should also be affected by the higher selic rate and by the higher uncertainties, given Brazil heavy political schedule in 2022 (see: 1 year countdown for the elections). Nonetheless, improvements in some regulatory framework and investment in assets conceded by the government could curb some of the investment weakness. Exports should not boost demand as well given expected global recovery moderation. Positive growth drivers for activity next year are the full normalization of mobility restrictions that will boost some components of services sector that are still depressed and a more robust social program that should be in place (Exhibit 44).

Inflation above the target for the 4th year in a row

We expect 2022 year-end inflation at 5.0% (from 10.1% expected in 2021) above the inflation target of 3.5%. Inflation should end 2021 at 10.1%, the highest level since 2015. Inflation was severely hit in 2021 by higher prices commodity prices especially fuel and energy prices amid a global supply demand shortage. Commodity prices shock was amplified by BRL depreciation in 2021 (7.8% expected depreciation in 2021) and by economy reopening in 2H21 that drove up services inflation.

For 2022, inflation should decelerate given that selic will be above neutral levels while activity weakening should also reduce inflationary pressures. Nonetheless, those factors should not be sufficient to drive inflation to the target, meaning that it will remain above the target for the 4th year in a row. Upside risks to our forecasts are the maintenance of higher commodity prices, fiscal stimulus and further BRL weakening amid an uncertain political year (Exhibit 45).

Exhibit 44: Activity indicators already losing strength in 3Q
Industrial production is already in negative territory – (3mma yoy)



Source: BCB and IBGE

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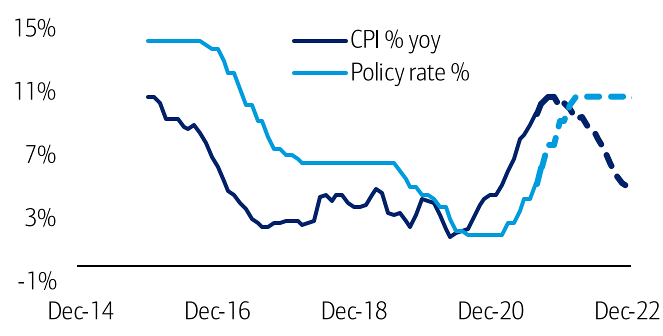
Exhibit 45: Rising interest rates should drive inflation down in 2022
BCB should take selic rate to 10.75% in 2022



Source: BCB and IBGE

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Selic: back at double digits; BRL to continue weakening

We expect selic rate at to end 2022 at 10.75% (from 9.25% in 2021) as above the target inflation and fiscal noise should force BCB to hike rates into more contractionary territory. We expect a hike of 150bps in December with the selic ending this year at 9.25%. For next year, we expect two hikes in the first two meetings of the year: 100bp in February, followed by 50bp in March. This would take the terminal Selic to 10.75% and our expectation at this point is for rates to stay at this level until the end of next year.

In spite of higher rates, deteriorating fundamentals and higher political/fiscal risk will keep BRL at weak levels. We expect USD/BRL at 5.7 in 2022-end (from 5.6 in 2021-end). We keep a cautious bias on the currency, in spite of the extremely high risk premium, large interest rate differential and light positioning, since we expect volatility to remain very high in coming months on the back of fiscal and political uncertainty.

Fiscal: still weak despite better starting point

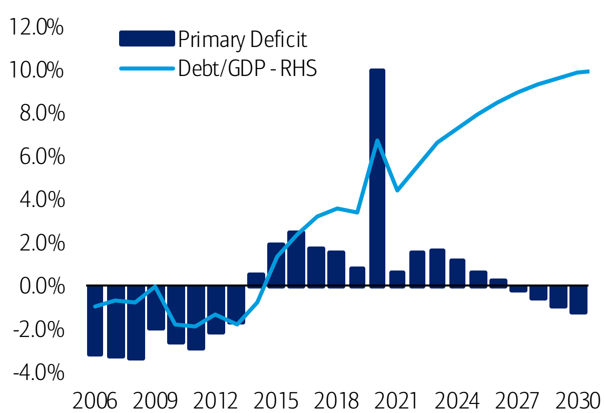
We expect Brazil fiscal situation to continue challenging in 2022 in spite of better starting point given 2021 higher tax collections. We expect primary deficit to GDP to be -1.6% while gross debt to GDP should be at 83.5% (from -0.7% and 78.9% of GDP, respectively). Brazil fiscal data should end 2021 at a better than expected level as higher inflation and activity recovery drove tax collections up in the year. Nonetheless, Brazil medium to long term fiscal situation likely will remain fragile. Notably next year we should have in place a more robust social program whose expenditures will be left out of the spending cap, which would undermine its credibility. Moreover, an environment of higher interest rates and low growth turns gross debt to GDP stabilization a less feasible scenario. It is worth noting that, measures that could improve country's fiscal situation like structural reforms, privatizations and concessions are less likely to occur as the window for approving them is closing as electoral season started earlier than expected this year.

Electoral season already started

Electoral season has started earlier than expected, considering that elections are already seen as one of the biggest tail risks for Brazil by investors. In October 2022, Brazilians should decide on the new president, governors, federal and state congressmen, and one third of Senate. More recent polls point for a polarized political run as the former president Lula (PT) and current president Jair Bolsonaro (no party) are the two front-runners, with the former being ahead of the latter and both having a sizable advantage against all third-way candidates. As it is right now, polls point to a scenario with Lula and Bolsonaro advancing to the second round with the Lula being the winner.

Exhibit 46: Debt to GDP should surpass 100% threshold in 2028

Higher rates and low growth should avoid early debt to GDP stabilization



Source: National Treasury

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Exhibit 47: 2022 electoral calendar

Brazil will face a heavy political schedule in 2022

Date	Event
04/04/22	Deadline to party affiliations/Ministries to resign
06/30/22	From this date pre-candidates are forbidden to present or comment on TV and radio
07/02/22	From this date it is forbidden to: Hire, dismiss, name, readapt public servants until the presidential inauguration Transfer resources from the federal government to states and municipalities that are not destined to fulfill a preexistent obligation
20-Jul to 05-Aug	Party conventions to define running candidates
08/15/22	Deadline to register candidates
26-Aug to 29-Sep	Period of electoral propaganda on radio and TV, first round
09/30/22	Electoral debates
10/02/22	First round elections
07-Oct to 27-Oct	Period of electoral propaganda on radio and TV, second round
10/30/22	Second round elections

Source: Arko Advice

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Mexico

Carlos Capistran
BofAS

Stability is a virtue

- Mexico's economy should grow by 2.5% in 2022. The main growth engine likely will continue to be the US economy. We see balanced risks to our forecast.
- Mexico has a high real rate and a relatively tight fiscal posture that should continue to bring stability to markets, despite high policy uncertainty and low investment.
- Inflation will likely surprise to the downside in 2H 2022, allowing Banxico to continue with a gradual tightening approach.

Growth and inflation surprised to the upside in 2021

Mexico's economic activity surprised to the upside in 2021 with 7% growth in the first half of the year. The surprise is mostly explained by strong US growth and a window between COVID waves that allowed some reopening in 2Q 2021. Manufacturing exports ex-autos and remittances have been the main engines of growth in 2021. However, the domestic economy remains subdued, in particular investment, given relatively tight fiscal and monetary policies and policy uncertainty. We were expecting high inflation, but inflation is much higher than anyone expected, which has put pressure on the central bank to hike rates.

Mexico's economic activity is losing steam

We expect the Mexican economy to grow 2.5% in 2022, a marked deceleration from the 5.8% that we expect for 2021 (Exhibit 1). The Mexican economy contracted in 3Q 2021 as a nasty third COVID wave hit the country, a ban to labor outsourcing impacted services and the global semi-conductors shortage impacted the auto sector. We expect the economy to recover in 4Q 2021 as COVID has receded and as most of the impact from the ban to labor is a one-off.

For 2022, the main engine of growth for the Mexican economy is likely to be the US economy through exports ex-autos and remittances (Exhibit 49). Domestic growth is likely to remain subdued for four main reasons: (i) policy uncertainty remains high, which will continue to have a negative impact on investment. In 2Q 2022 there will be a referendum to see if AMLO's mandate is revoked (we expect AMLO to remain in office) and Congress will likely vote on the energy counter-reform (we expect Congress to reject

Exhibit 48: Macroeconomic outlook
% year-on-year growth rate, unless otherwise indicated

	2021	2022	2023
Real GDP growth	5.8	2.5	2.0
CPI inflation (eop)	7.1	3.7	4.0
Bank of Mexico overnight rate (eop)	5.25	6.50	6.50
MXN (eop)	20.60	21.00	21.70
Brent crude oil ($bbl average)	72.0	85.0	75.0
US real GDP growth	5.6	4.0	2.2
US Fed Funds rate (eop)	0.25	1.00	2.00

Source: BofA Global Research

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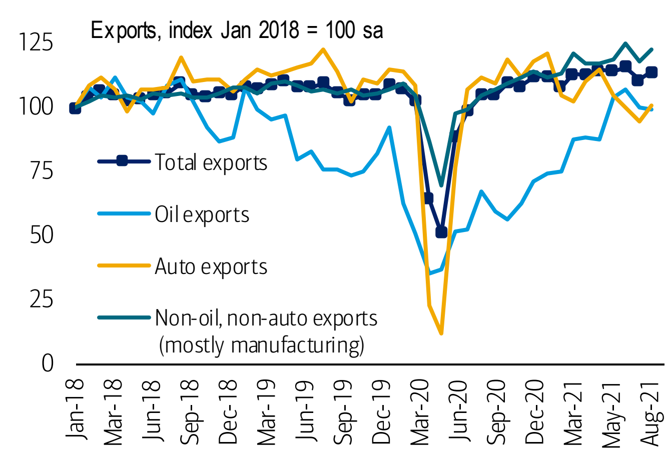
Exhibit 49: Mexico's exports
Auto exports have struggled to recover and remain under pressure



Source: BofA Global Research, INEGI

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it); (ii) monetary policy will move from stimulating to neutral, so credit will not be a major contributor to the recovery; (iii) fiscal policy remains insufficient to jump-start growth as the primary deficit will remain relatively close to cero; and (iv) COVID will likely become endemic as vaccination remains behind other countries in the region.

Inflation is likely to surprise to the downside in 2022

We expect inflation to end-2022 at 3.7%, a welcomed deceleration from the 7.1% that we expect for end-2021. Inflation in Mexico has continually surprised to the upside in 2021 and it is currently at 6.2% and increasing. Core inflation is at 5.2% and is also increasing. Inflation is high in Mexico in part due to the pandemic but also because Mexico has had its own domestic share of negative supply shocks such as large annual increases to the minimum wage, which we expect to continue, and very little fiscal help throughout the pandemic. However, we believe there is a good chance that inflation decelerates in 2022 and ends the year below 4% as: (i) global supply will likely recover some ground as COVID is contained. (ii) commodity prices are unlikely to keep increasing significantly as China is decelerating; and (iii) in Mexico there is plenty of slack in the labor market, which will take many quarters to be absorbed.

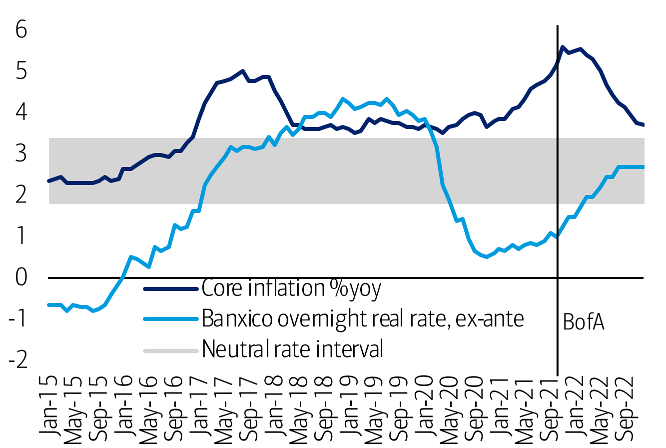
We expect Banxico to hike to 6.5%

We expect the central bank of Mexico to keep hiking to put the overnight rate target at 6.5% by 2Q 2022. At that level, the real ex-ante policy rate would be about the level Banxico considers neutral (2.6%, Exhibit 50). We expect Banxico to keep the pace at 25bp per meeting. Banxico is hiking to prevent high inflation to contaminate expectations. It will continue hiking into1H 2022 anticipating the Fed. But weak growth and inflation slowing down in 2H 2022 will prevent Banxico from hiking beyond neutral, in our view.

Uncertainty remains high

Global uncertainty likely will remain high in 2022 as COVID continues (so supply disruptions will remain), the Fed starts its hiking cycle (and other DM central banks deal with high inflation) and China decelerates. Domestically policy uncertainty remains high, Banxico is dealing with high inflation and fiscal policy is trying to provide some stimulus but without increasing debt (we have debt increasing slightly as percentage of GDP). Uncertainty cuts both ways, and we see symmetric risks to our GDP growth, inflation and monetary policy forecasts. Long term Mexico's potential has likely decreased due to many years of weak investment. On the upside, Mexico's best hope to growth remains supply chains moving from Asia to North America (re-shoring, Exhibit 51).

Exhibit 50: Real rate and core inflation
We expect Banxico to put its real rate in the neutral interval in 2022



Source: BofA Global Research, INEGI, Banxico, Bloomberg

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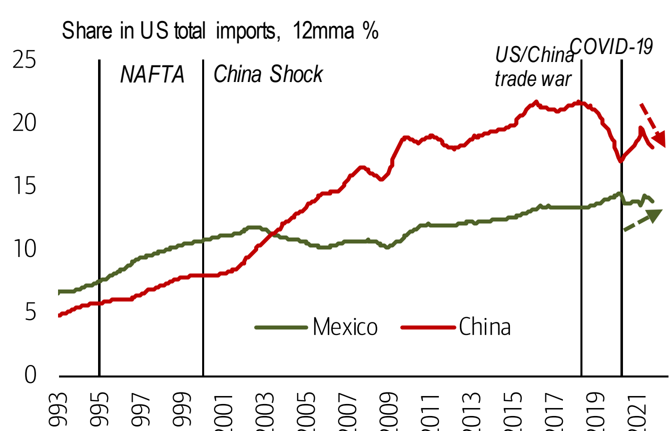
Exhibit 51: Share in US imports
Mexico may benefit from reshoring



Source: BofA Global Research, US Census Bureau

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Argentina, Andeans and Caribbean

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Argentina: life after elections

The government lost the mid-term election by a wide margin, which increased the chances of policy regime change in the medium term. The president said the government will deepen efforts to reach an agreement with the IMF. They will send a macro plan to congress to make progress in that direction, seeking consensus about an agenda with the opposition. A fiscal and FX adjustment are key to stabilize the economy and reach an agreement with the IMF. We expect an acceleration of the crawling peg (but not a devaluation). The plan should help accumulate international reserves, which are critically low. We expect the IMF agreement signed by March.

Chile: Challenging macro and political dynamics

Chile is facing much political and policy uncertainty with binary outcome in presidential elections, congress elections, drafting of a new constitution. The new president will face important governability challenges with a more fragmented congress, the constitutional convention and a high fiscal deficit. We expect the new constitution to be maximalist with details about social spending targets putting pressure on taxes. It could also raise uncertainty about regulation and property rights. The Senate rejected the 4th pension bill withdrawal, bringing relief to local markets, but pension reforms talks will continue.

GDP recovered faster than expected (+11.5% this year) amid a consumption boom triggered by massive Covid stimulus and fast reopening. This will take inflation to 6.3% this year. We forecast BCCh will hike rates to 4.75% next year, (from 2.75%). We believe investment and potential growth will slow down amid much policy uncertainty. We expect about 1.8% average GDP growth in the next two years.

Colombia: ripple effects from the presidential elections

Looking into 2022, Colombia faces a presidential election that is likely to affect macroeconomic conditions. Colombia may be the only South American country whose economic policies have not moved like a pendulum since the 1960s, from right to left and vice versa. All of its governments in the past 60 years have been market-friendly. Now, for the first time in decades, a left-wing populist candidate, Gustavo Petro, appears as the front-runner in the polls. It is far from clear if Petro will win the presidency, because anything can happen in the second-round (run-off). But at least one thing likely; this will be an election that creates significant uncertainty. Private investment decisions likely will be put on hold in 1H22, which coupled with tighter fiscal and monetary policies should be conducive to slower growth. We expect a sequential slowdown (qoq) ahead. The exchange rate likely will also absorb part of the uncertainty, putting upward pressure on inflation. In our view, the Central Bank will react by hiking rates above the neutral level (4.5%), to 5% by September 2022. That is 250bp of hikes from the current policy rate.

Peru: macro conditions should be stable as long as metal prices remain high

We expect Peru's GDP growth to post 13.3% in 2021 – the highest in Latam – and 3.5% in 2022. Metal prices, arguably the most powerful driver of the Peruvian economy in the past, remain very high. Our commodities team expects copper prices at USc/lb 448 (average) for next year. In our view, this is more than enough to offset the domestic headwinds; namely, the weak business confidence caused by political instability, and the drag from tighter macro policies. Inflation is close to hitting a 13-year peak, and the Central Bank is already hiking at an accelerated pace, 50bp in each of the past three meetings. We expect the policy rate to reach 4.5% by August of 2022 – above the neutral level (3.5%) – up from the current level of 2%.

Ecuador: focus on structural reforms

We have become more constructive on Ecuador's story. Prospects for structural reforms are promising, with the exception of labor reform. The agenda of the new government is focused on tax reform (to raise revenues), opening the economy to trade (from high protection levels), deregulation (mainly in the oil, financial and telecom industries), and making the labor market more flexible. The President's high approval – bolstered by a very successful vaccine rollout – provides the Lasso administration with political capital. Moreover, Ecuador is benefitting from high oil prices. The IMF program is going well and we see the government committed to meeting the program's fiscal targets. We expect the economy to expand 3.5% in 2022, above long-term average growth rate.

Costa Rica: on a much more stable path

Had Costa Rica not secured an IMF deal in 2021, by now there would have been significant chances of a credit event. Funding needs north of 10% for several years, and a large primary deficit prior to the pandemic, put them in a tough spot. Nevertheless, the government has shown discipline in meeting the fiscal targets of the IMF program, which has catalyzed low-cost financing from other multilateral creditors and strengthened the confidence of domestic investors. The public employment reform – critical to receive the next IMF disbursement – is moving ahead in Congress. Moreover, the forthcoming presidential elections – to be held in February 2022 – do not have any leading candidates that pose a threat to the economy. That is uncommon in Latam.

Dominican Republic: maybe the best macro story in Latam

At the current juncture, investors probably have a bitter-sweet flavour about DomRep. Bitter because the fiscal reform that had been trumpeted by the government throughout year – potentially a trigger for a credit rating upgrade – failed. Despite President Abinader's high approval and the muscle of the ruling party in Congress, the government decided to postpone it. A missed opportunity to address the Dominican economy's main vulnerability; that is, rising public debt. However, that is not to say DomRep isn't the best macro story in LatAm at this point. It will probably be the fastest-growing economy in the region in 2022, feature one of the most impressive fiscal consolidations, progress on structural reforms, all in the context of political stability.

El Salvador: another Latam country depending on an IMF deal

After Argentina, Ecuador, Costa Rica and Honduras, the next country in Latam that is seeking an IMF program to stabilize its macroeconomic conditions is El Salvador. There are other Latam countries that have IMF credit lines, but their nature is precautionary. In the case of El Salvador, the IMF program is critical to regain access to markets, which is necessary to cover funding needs (~9% of GDP for both 2022-23). Its risk premium is one of the highest in the region. Moreover, El Salvador is fully dollarized, so it cannot monetize the fiscal deficit like Argentina. In 2022, we believe investors will pay attention to the negotiations with the IMF. We have the out-of-consensus view that El Salvador will get an IMF program in 1Q22.

Panama: the challenge of not becoming a fallen angel

Panama's main challenge in 2022 will be avoiding the loss of investment-grade status, the fate suffered by Colombia and Brazil. Being downgraded to high yield comes with costs, in the form of higher interest rates and financial instability. The cases of Colombia and Brazil are unsettling for Panama because of similarities. The parallel with Colombia is that Panama also suffered a large increase in the debt ratio, to almost 70% of GDP, a level no longer consistent with IG rating. The similarity with Brazil is the unsustainable pension system. However, we are constructive on Panama. In our view, GDP growth will be robust in 2022 (5%) and the government will deliver fiscal consolidation, thereby preventing the loss of IG from at least two of the three main rating agencies.

Global Economic forecasts

Exhibit 52: Global economic forecasts

Global growth at 5.8% in 2021 and 4.2% om 2022

	GDP growth, %				CPI inflation*, %				Short term interest rates**, %			
	2020	2021F	2022F	2023F	2020	2021F	2022F	2023F	Current	2021F	2022F	2023F
Global and regional aggregates												
Global	-3.1	5.8	4.2	3.5	2.6	3.9	4.3	3.2	2.61	2.60	2.94	3.24
Global ex US	-3.1	5.8	4.3	3.8	2.9	3.8	4.3	3.3	3.15	3.14	3.39	3.54
Global ex China	-4.5	5.3	4.3	3.0	2.7	4.7	4.9	3.6	2.16	2.26	2.76	3.14
Developed Markets	-4.9	4.9	3.8	2.2	0.7	3.1	3.3	1.9	-0.11	-0.10	0.28	0.79
Emerging Markets	-1.9	6.4	4.5	4.4	4.0	4.5	5.0	4.0	4.60	4.55	4.85	4.96
Emerging Markets ex China	-4.1	5.7	4.8	4.0	4.8	6.4	6.7	5.3	4.73	4.95	5.56	5.75
Europe, Middle East and Africa (EMEA)	-4.7	5.1	3.6	2.6	2.6	5.0	5.2	3.6	2.76	2.81	2.95	2.96
European Union	-6.0	5.0	3.7	2.4	0.7	2.8	2.9	1.7	-0.18	-0.13	0.08	0.07
Emerging EMEA	-2.1	5.0	3.5	3.3	5.5	8.2	8.5	6.4	6.84	6.96	7.23	7.17
Emerging Asia	-0.8	6.7	5.3	5.2	2.9	2.0	2.9	2.6	3.68	3.43	3.58	3.88
ASEAN	-3.5	3.2	5.5	5.3	1.3	2.0	2.7	2.7	2.66	2.67	3.22	3.91
Latin America	-6.9	6.9	2.2	2.2	7.3	10.7	10.5	7.8	5.51	6.37	7.85	7.32
G6												
US	-3.4	5.6	4.0	2.2	1.2	4.6	4.6	2.6	0.13	0.13	0.88	1.88
Euro area	-6.5	5.0	3.6	2.1	0.3	2.5	2.4	1.4	-0.50	-0.50	-0.50	-0.50
Japan	-4.6	2.0	3.8	1.8	0.0	-0.2	0.7	0.6	-0.10	-0.10	-0.10	-0.10
UK	-9.7	6.9	4.1	1.3	0.9	2.5	4.0	1.8	0.10	0.10	0.50	0.75
Canada	-5.6	4.5	3.8	3.5	0.7	3.4	3.4	2.0	0.25	0.25	1.00	2.00
Australia	-2.4	3.8	4.0	2.7	0.9	2.7	2.7	2.5	0.10	0.10	0.20	1.13
Euro area												
Germany	-4.9	2.5	2.8	2.0	0.4	3.1	2.5	1.5	-0.50	-0.50	-0.50	-0.50
France	-8.0	6.7	3.3	2.3	0.5	2.0	2.2	1.3	-0.50	-0.50	-0.50	-0.50
Italy	-9.0	6.3	4.0	1.8	-0.1	1.7	2.2	1.5	-0.50	-0.50	-0.50	-0.50
Spain	-10.8	4.6	6.0	3.0	-0.3	2.8	2.8	0.9	-0.50	-0.50	-0.50	-0.50
Netherlands	-3.8	4.5	2.9	1.8	1.1	2.4	2.5	1.6	-0.50	-0.50	-0.50	-0.50
Belgium	-5.7	6.0	2.9	2.2	0.4	2.9	2.9	1.8	-0.50	-0.50	-0.50	-0.50
Austria	-6.8	4.6	3.8	2.2	1.4	2.7	2.4	1.4	-0.50	-0.50	-0.50	-0.50
Greece	-7.8	8.6	3.8	2.5	-1.3	0.4	1.9	1.2	-0.50	-0.50	-0.50	-0.50
Portugal	-8.4	4.5	5.6	2.3	-0.1	0.8	1.5	1.0	-0.50	-0.50	-0.50	-0.50
Ireland	5.8	6.6	4.1	4.6	1.1	1.2	1.6	1.9	-0.50	-0.50	-0.50	-0.50
Finland	-2.9	3.4	1.9	1.5	0.4	2.0	2.1	1.1	-0.50	-0.50	-0.50	-0.50
Other developed economies												
New Zealand	-4.0	6.5	3.3	2.5	1.5	3.5	2.5	2.0	0.50	0.75	1.75	1.75
Switzerland	-2.5	2.9	2.1	1.5	-0.7	0.5	0.9	0.5	-0.75	-0.75	-0.75	-0.75
Sweden	-2.9	4.2	3.3	2.2	0.7	2.5	2.2	1.5	0.00	0.00	0.00	0.00
Emerging Asia												
China	2.3	7.7	4.0	5.3	2.5	0.9	2.0	1.7	4.35	3.85	3.60	3.60
India	-7.0	8.1	9.5	6.0	6.6	5.1	5.7	5.2	4.00	4.00	4.75	5.50
Indonesia	-2.1	3.2	5.0	5.3	2.0	1.5	2.8	3.1	3.50	3.50	4.25	5.00
Korea	-0.9	4.1	3.1	2.3	0.5	2.2	1.8	1.6	0.75	1.00	1.25	1.50
Taiwan	3.1	6.0	2.6	2.2	-0.2	1.9	1.7	1.1	1.13	1.13	1.38	1.63
Thailand	-6.1	0.9	3.9	4.7	-0.9	1.1	2.0	1.1	0.50	0.50	0.75	1.25
Malaysia	-5.6	3.0	7.0	4.9	-1.1	2.4	2.0	2.3	1.75	1.75	2.25	3.00
Philippines	-9.5	5.2	7.2	6.0	2.6	4.3	3.2	3.2	2.00	2.00	2.25	2.50
Singapore	-5.4	6.5	4.0	2.6	-0.2	2.1	2.3	1.8				
Hong Kong	-6.1	6.4	2.4	2.6	0.3	1.5	1.8	2.0	0.20	0.35	1.10	2.10
Vietnam	2.9	2.2	7.2	7.3	3.2	1.9	3.7	3.3	4.00	4.00	4.50	5.50

Source: BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 53: Global economic forecasts

Global growth at 5.8% in 2021 and 4.2% om 2022

	GDP growth, %				CPI inflation*, %				Short term interest rates**, %			
	2020	2021F	2022F	2023F	2020	2021F	2022F	2023F	Current	2021F	2022F	2023F
Latin America												
Brazil	-4.1	4.9	1.1	1.8	3.2	8.3	7.8	3.8	7.75	9.25	10.75	9.50
Mexico	-8.5	5.8	2.5	2.0	3.4	5.6	4.9	3.8	5.00	5.25	6.50	6.50
Argentina	-9.9	8.5	2.0	2.3	42.7	48.3	49.0	42.8	38.00	40.00	36.00	36.00
Colombia	-6.8	9.5	4.0	2.8	2.5	3.4	4.4	3.3	2.50	3.00	5.00	5.00
Chile	-5.8	11.4	2.0	1.5	3.0	4.4	5.5	3.5	2.75	3.50	4.75	4.00
Peru	-11.0	13.3	3.5	3.0	1.8	3.9	5.0	3.1	2.00	2.50	4.50	4.50
Ecuador	-7.8	3.0	4.0	3.5	-0.9	1.2	2.0	1.8				
Uruguay	-5.9	3.5	3.0	3.0	9.4	7.9	6.8	6.0				
Costa Rica	-4.1	5.5	4.0	3.5	0.7	2.8	3.3	3.0	0.75	0.75	2.50	4.00
Dominican Republic	-6.7	13.0	5.3	5.0	5.6	7.7	5.7	4.0	3.00	3.00	5.00	5.50
Panama	-17.9	9.5	5.0	5.0	0.3	1.0	1.5	0.9				
El Salvador	-7.9	11.0	4.0	3.0	-0.1	6.0	3.0	2.0				
EEMEA												
Russia	-3.1	4.2	2.5	2.2	3.4	6.6	5.9	4.0	7.50	8.00	7.25	6.50
Turkey	1.8	9.4	3.0	4.5	12.3	17.9	21.3	16.1	15.00	14.00	14.00	14.00
Nigeria	-1.8	2.5	2.1	2.1	13.2	16.7	13.2	11.6	11.50	11.50	13.50	14.00
Egypt	3.6	3.3	5.0	5.5	5.7	4.7	6.0	6.5	8.25	8.25	8.25	8.25
Poland	-2.6	5.0	4.7	4.7	3.4	4.9	6.1	3.3	1.25	1.75	3.50	3.50
South Africa	-6.4	5.1	1.8	1.8	3.3	4.4	4.3	4.5	3.75	3.75	4.75	5.50
Romania	-3.7	6.4	4.7	4.0	2.6	5.0	6.0	3.5	1.75	1.75	3.00	3.00
Ukraine	-4.0	3.0	3.9	3.8	2.7	9.3	7.4	5.5	8.50	8.50	7.00	6.00
Czech Republic	-5.8	3.0	4.0	3.8	3.2	3.8	6.0	2.2	2.75	3.25	4.00	3.50
Israel	-2.5	6.5	5.0	3.5	-0.6	1.6	2.3	1.6	0.10	0.10	1.00	1.50
Hungary	-5.1	6.8	4.8	3.7	3.3	5.0	5.4	3.2	2.10	2.40	3.90	3.90
Saudi Arabia	-4.1	1.8	4.9	2.4	3.4	4.0	2.0	2.0	0.50	1.00	1.75	2.75

Source: BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 54: Real GDP growth, qoq annualized %

Global growth at 5.8% in 2021 and 4.2% om 2022

	1Q 2020	2Q 2020	3Q 2020	4Q 2020	1Q 2021	2Q 2021	3Q 2021	4Q 2021	1Q 2022	2Q 2022	3Q 2022	4Q 2022	2021	2022
Developed Markets														
United States	-5.1	-31.2	33.8	4.5	6.3	6.7	2.0	6.0	4.0	4.0	3.0	2.0	5.6	4.0
Euro Area	-13.2	-39.2	60.7	-1.5	-1.2	8.7	9.1	1.4	3.2	2.5	2.2	2.2	5.0	3.6
Japan	-2.3	-28.2	23.5	11.8	-4.1	1.5	-3.0	6.7	4.9	5.8	3.9	1.1	1.8	3.8
United Kingdom	-10.4	-58.1	90.2	4.5	-5.3	23.9	5.1	4.9	2.4	1.6	1.6	1.6	6.9	4.1
Canada	-7.9	-38.0	41.7	9.3	5.5	-1.1	2.0	4.2	4.3	4.8	4.6	4.5	4.5	3.8
Australia	-1.3	-25.1	15.0	13.3	7.8	2.7	-10.5	7.5	8.2	4.7	5.6	4.0	3.8	4.0
G6 Aggregate	-7.7	-35.2	44.5	3.9	2.0	7.4	3.5	4.5	3.9	3.6	2.9	2.1	4.9	3.9
Emerging Markets														
China	-32.9	50.2	12.1	13.4	0.8	4.9	0.8	3.7	4.0	4.5	5.5	5.7	7.7	4.0
Indonesia	-1.4	-24.9	12.3	9.8	5.3	1.2	-2.0	9.1	6.1	5.2	5.3	5.5	3.2	5.0
Korea, Republic Of	-5.0	-12.0	9.2	4.6	7.1	3.1	1.2	5.8	5.4	0.9	0.3	3.1	4.1	3.1
Thailand	-9.6	-33.4	28.9	8.4	0.6	-0.5	-3.8	5.2	3.1	5.7	8.4	6.7	0.9	3.9
Singapore	-2.4	-43.0	41.0	15.9	13.9	-5.5	3.1	5.4	6.7	4.6	3.1	3.0	6.5	4.0
Hong Kong	-18.5	-1.6	10.0	2.0	23.9	-3.6	0.4	0.0	3.6	5.0	6.4	-1.1	6.4	2.4
Brazil	-8.0	-32.1	34.6	13.1	4.9	-0.2	0.8	1.6	0.6	0.6	0.6	0.6	4.9	1.1
Mexico	-4.1	-52.1	61.1	14.1	4.5	6.0	-0.8	2.4	2.7	2.4	3.3	3.2	5.8	2.5
Colombia	-9.2	-47.3	44.6	27.2	12.2	-9.2	24.9	4.5	2.0	0.8	2.0	2.4	9.5	4.0
Chile	12.4	-43.9	24.2	28.0	13.4	4.1	21.0	5.2	-3.2	-3.2	-2.0	-1.2	11.4	2.0
Peru	-23.2	-70.3	194.0	38.8	-1.0	3.2	12.6	2.0	2.4	2.8	2.8	2.8	13.3	3.5
Turkey	-0.1	-36.6	83.6	4.9	9.0	3.7	6.0	2.7	1.1	3.8	3.2	3.4	9.4	3.0
South Africa	-1.8	-51.7	66.5	11.5	3.3	4.9							5.1	1.8

Source: BofA Global Research

BofA GLOBAL RESEARCH

Monetary policy forecasts

Exhibit 55: Key meeting dates and expected rate change (bp)

An increasing number of central banks are beginning to remove accommodation

	Current	21-Oct	21-Nov	21-Dec	22-Jan	22-Feb
Developed Markets						
Fed	0.00	-	unch	15th	26th	-
ECB	0.00	unch	-	16th	-	3rd
BoJ	-0.10	unch	-	17th	18th	-
BoE	0.10	-	unch	16th	-	**+15(3rd)**
BoC	0.25	-	-	8th	26th	-
Riksbank	0.00	-	24th	-	-	9th
SNB	-0.75	-	-	16th	-	-
Norges Bank	0.25	-	unch	16th	-	-
RBA	0.10	-	-	-	-	-
RBNZ	0.25	+25	24th	**+25**	-	-
Emerging Asia						
China (lending rate)	3.85	**-10**	-	**-15**	-	-
Req. res. ratio*	12.00	-	-	-	-	-
India**	4.25	-	-	-	-	-
Repo rate	4.00	-	-	8th	-	9th
Cash res. ratio	4.00	-	-	8th	-	9th
Korea	0.75	-	25th	-	-	-
Indonesia	3.50	unch	unch	16th	-	-
Taiwan	1.13	-	-	16th	-	-
Thailand	0.50	-	unch	22nd	-	-
Malaysia	1.75	-	unch	-	-	-
Philippines	2.00	-	unch	16th	-	-
Latin America						
Brazil	7.75	-	-	8th	-	2nd
Chile	2.75	-	-	14th	-	-
Colombia	2.50	+50	-	**+25 (17th)**	**+25**	-
Mexico	5.00	-	+25	16th	-	-
Peru	2.00	+50	unch	**+25 (9th)**	**+25**	**+25**
Emerging EMEA						
Czech Republic	2.75	-	+125	**+25(22nd)**	-	**+25**
Hungary	2.10	+15	+30	**+15(14th)**	-	-
Israel	0.10	-	22nd	-	3rd	21st
Poland	0.10	-	+75	8th		
Romania	1.25	+25	+25		**+25(10th)**	**+25(9th)**
Russia	7.50	-	-	17th	-	11th
South Africa	3.75	-	+25	-	-	-
Turkey	15.00	-	-100	16th	-	-

Note: Bolded data are expectations in basis points. "—" denotes no meeting. TBA: MPC meeting not yet set. *Major five banks. **Reverse repo rate.

Source: BofA Global Research, Central Banks

BofA GLOBAL RESEARCH

FX, rates and commodity forecasts

Exhibit 56: Key FX rates and commodity forecasts

2021-2022

	Spot	21-Dec	22-Mar	22-Jun	22-Sep	22-Dec	23-Mar	23-Jun	23-Sep	23-Dec
FX forecasts										
G6										
EUR-USD	1.13	1.14	1.13	1.12	1.11	1.10	1.11	1.12	1.14	1.15
USD-JPY	114	116	116	118	118	118	117	116	115	114
EUR-JPY	129	132	131	132	131	130	130	130	131	131
GBP-USD	1.35	1.34	1.30	1.27	1.25	1.24	1.26	1.27	1.30	1.31
USD-CAD	1.26	1.26	1.23	1.20	1.20	1.20	1.20	1.20	1.20	1.20
AUD-USD	0.73	0.73	0.74	0.74	0.76	0.78	0.79	0.80	0.80	0.80
Asia										
USD-CNY	6.39	6.45	6.60	6.70	6.70	6.60	6.50	6.40	6.30	6.20
USD-INR	74.24	75.00	75.50	77.00	77.00	76.00	75.00	75.00	75.00	75.00
USD-IDR	14238	14300	14400	14500	14500	14500	14500	14500	14600	14600
USD-KRW	1185	1190	1210	1220	1230	1210	1190	1180	1170	1160
Latin America										
USD-BRL	5.56	5.60	5.60	5.70	5.80	5.70	5.60	5.60	5.50	5.50
USD-MXN	20.80	20.60	20.70	20.80	20.90	21.00	21.20	21.40	21.50	21.70
Emerging Europe										
EUR-PLN	4.69	4.58	4.55	4.50	4.45	4.45	4.45	4.45	4.45	4.45
USD-RUB	73.44	68.00	68.00	68.00	68.00	68.00	68.00	68.00	68.00	68.00
USD-TRY	11.22	11.35	12.00	12.40	12.80	13.25	13.60	14.00	14.20	14.50
USD-ZAR	15.70	15.00	15.50	15.00	14.50	15.00	15.00	15.00	15.00	15.00
Rates forecasts										
US 10-year	1.53	1.65	1.75	1.85	1.90	2.00				
Germany 10-year	-0.34	-0.20	-0.20	-0.15	-0.10	-0.05				
Japan 10-year	0.08	0.11	0.13	0.15	0.17	0.19				
UK 10-year	0.88		1.05	1.15	1.25	1.30				
Canada 10-year	1.64	1.70	1.90	2.05	2.05	2.10				
Commodities forecasts										
WTI Crude Oil - $/bbl	75.45	85.00	90.00	120.00	80.00					
Brent Crude Oil - $/bbl	78.27	83.00	87.00	117.00	76.00					

Spot exchange rate as of day of publishing. The left of the currency pair is the denominator of the exchange rate. Currency forecasts are for end of period.

Source: BofA Global Research

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