

International Commentary — August 2, 2021

## Laying Out Economic Scenarios...A "What If" Game

### Summary

The spread of the Delta COVID variant has raised some concerns over the pace of global economic growth. Rising case numbers have reintroduced fears that restrictions could be imposed, or at a minimum, consumer behavior might be disrupted. For now, we remain fairly confident in the underlying health of the global economy and optimistic on global growth prospects; however, we believe risks around our global growth forecast are tilted to the downside. In this report, we lay out our base case assumptions and forecasts for the global economy, while also highlighting what a downside scenario for the global economy could entail and how our forecasts could change. On the other hand, should COVID cases and fears recede quickly and consumers disregard the current wave of infections, we lay out what an upside scenario for the global economy could look like as well.

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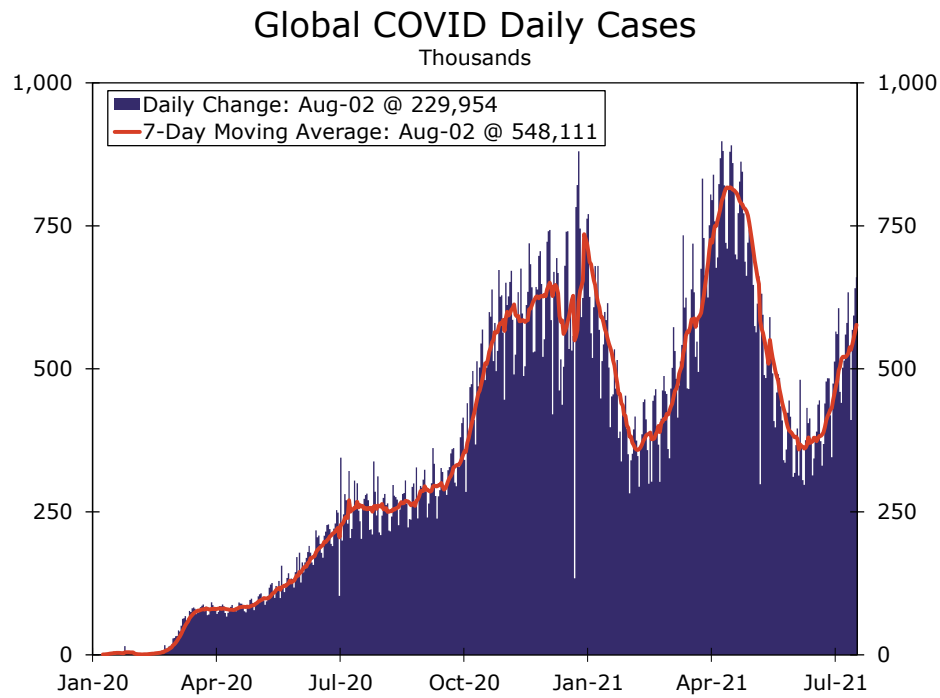
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## Global Growth Risks Are Building

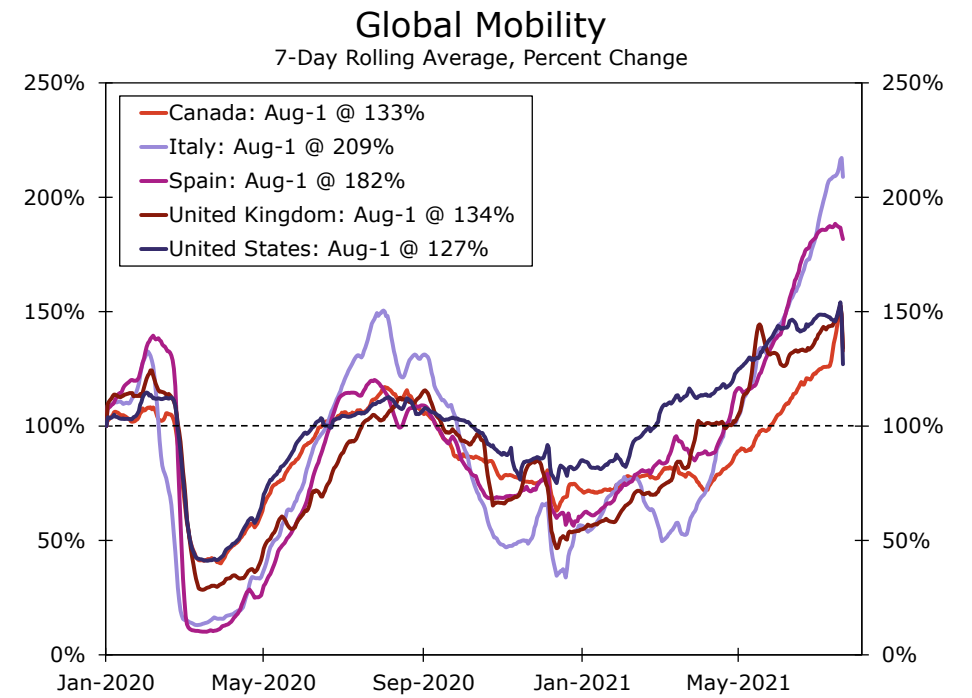
Seemed like not long ago COVID cases were falling, vaccine distribution was improving, and the world was finally on a path toward getting back to "normal." While the world is certainly more protected from COVID today than this time last year now that vaccines are available, confirmed case numbers are once again rising. The renewed wave of infections can be attributed to the Delta variant of the virus, which originated in India earlier this year. As more research was conducted, agencies, such as the World Health Organization, determined the Delta variant is more transmissible than prior strains of the virus. To that point, the Delta strain now makes up about 80% of all infections globally and has been detected in over 90 countries. In addition, the Delta variant is responsible for pushing global confirmed case numbers up to around 548,000 infections per day on average, the highest global average since early May (Figure 1).

Figure 1



Source: Bloomberg LP and Wells Fargo Securities

Figure 2



Source: Apple and Wells Fargo Securities

Despite the rise in infections, most governments have been hesitant to reimpose restrictions or lockdowns. With the exception of Australia and parts of Southeast Asia, governments around the world have opted to take a more flexible stance on the virus as vaccines are more widely available and in an effort to protect against another sharp economic downturn. Without new restrictions, global mobility has been able to remain elevated and above pre-COVID levels (Figure 2). United States mobility is high at 127% of pre-COVID levels, while Canada mobility is also relatively elevated. In the United Kingdom, the recent full reopening of the economy has pushed mobility above pre-virus levels, while mobility in Italy and Spain is exceptionally high. In our view, mobility is a key indicator of economic activity and consumer behavior as well as a good gauge of how "COVID fears" are evolving at an individual country level, but also from a global perspective. For now, mobility is above pre-COVID levels in some of the larger more systemically important countries; however, most recently trends are a little concerning. In the United States, a sharp drop in mobility is coinciding with a sharp rise in COVID cases, while mobility appears to be edging lower in Italy and Spain. For the time being, we can infer that fears surrounding the spread of the Delta variant are not having a material impact on consumer activity as mobility is still relatively elevated, although a more material trend lower could raise additional concerns on the pace of consumer activity.

### We Remain Optimistic on the Global Economy...

We mention mobility not only because we believe these data are good indicators of activity, but also because elevated and steady mobility is a key assumption underpinning our base case scenario for our global economic outlook. To that point, we find it helpful to lay out how we are thinking about the global economy amidst the renewed spread of COVID. As of now, we are forecasting the global economy under the assumption that COVID cases will stay elevated; however, governments will choose not to impose any significant new restrictions. With no new restrictions in place, mobility remains well above pre-COVID levels, and excess cash on household balance sheets continues to get deployed as consumer spending patterns are not disrupted. Over the second half of this year and into 2022, we believe consumption will be the biggest engine of global economic growth and support the global economy going forward. In our view, this scenario has a 60%-70% likelihood of materializing.

Under these assumptions, we forecast the global economy to perform quite well. In 2021, we forecast the global economy to grow 6.3%, the fastest expansion in decades, with advanced economies growing 5.8% and the emerging markets growing 6.6%. We expect this strong economic momentum to carry forward into 2022 as well. In that context, we expect the global economy to expand at above trend growth rates and grow 4%, led by the advanced economies. As far as our outlook on currency markets, in the short-term we believe the U.S. dollar can strengthen as the U.S. economy performs well and as the Fed gets closer to announcing a reduction in the pace of its bond purchases. Over the longer-term, our assumptions lead us to believe the U.S. dollar should weaken as a steady global economic recovery results in capital flows toward foreign currencies, and while foreign central banks reduce accommodative monetary policy at a quicker pace even as the Fed is in taper mode.

### ...Although Risks Are Tilted to the Downside

While base case scenarios and forecast get the most attention, we also believe the downside scenario for the global economy warrants some focus, particularly as we see risks around global growth as tilted toward a slower pace of expansion. In our view, the downside scenario for the global economy is centered around the outbreak of the Delta variant; however, in order for the global economy to see a longer-lasting impact COVID cases would need to rise significantly. So significantly that governments around the world implement new restrictions to curb mobility and "COVID fears" rise to the point where consumer spending patterns are disrupted across the G10 economies as well as in the emerging markets. Should this scenario unfold, financial market volatility would likely rise significantly and investors would seek safe haven assets such as the U.S. dollar and pull capital from risk-sensitive currencies in the G10 and emerging markets. As of now, we attach a 20%-30% probability of this scenario unfolding; however, the likelihood of this scenario materializing has increased over the last month.

As consumption patterns change and investors become more risk-averse, the global economy would likely slow. In our view, this scenario shaves between 0.25%-0.50% off global growth in 2021, with a more pronounced impact on the global economy in 2022. Global growth could slow to between 5.75%-6% this year, while more trend-like growth rates, likely around 3%-3.5%, could be realized in 2022. Our currency market forecasts under this scenario would materially change as well. In the short-term, the U.S. dollar could see more upside than we currently expect and the U.S. dollar index could move higher by around 3%-4%. On the other hand, G10 currencies would weaken around 3% and the more risk-sensitive emerging market currencies would come under the most pressure. Over the longer-term, we believe our core forecast of U.S. dollar weakness would be delayed and the greenback would be more resilient over a 12-18 month time horizon. As safe haven support keeps U.S. dollar strength intact, foreign currencies, especially emerging market currencies, would continue to experience depreciation pressure.

### An Extreme Upside Scenario Does Exist

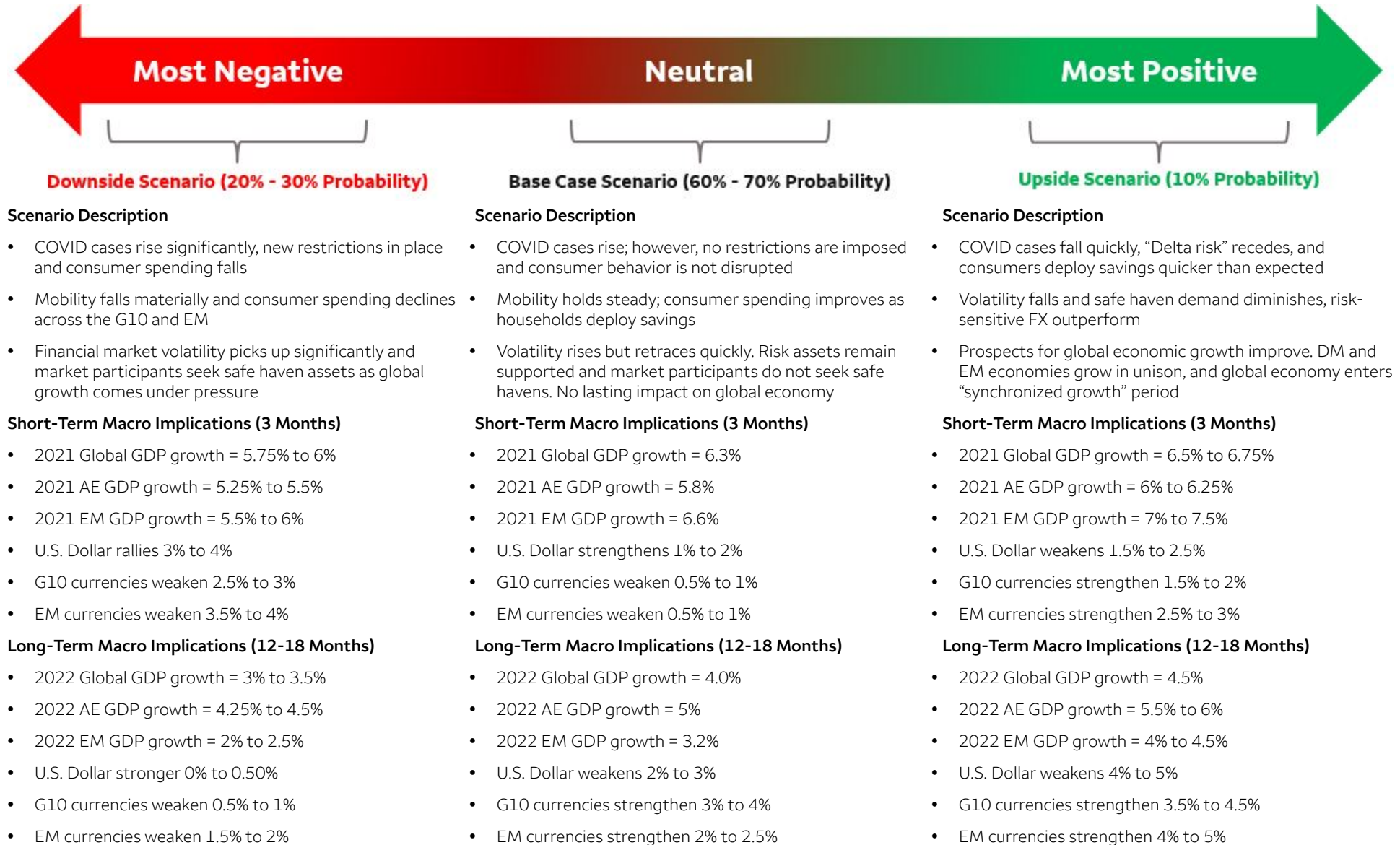
As we note above, we feel as if risks around global economic growth are tilted to the downside (i.e. slower global growth than we currently expect); however, a scenario still exists where the global economy could outperform. In order for the global economy to outperform, COVID cases would need to fall quickly and risks surrounding the Delta variant would also need to fade very fast. In this scenario, consumers would have the ability to deploy excess savings quicker than we expect, which could lead to a tailwind for economic growth. We also believe that investors would seek to deploy more capital into financial markets, particularly risk-sensitive asset classes, while multi-national corporations would feel more comfortable making longer-term investments as uncertainty recedes. This scenario would likely yield the most benefit, and we could enter into a period of synchronized global growth. The likelihood of this scenario is rather slim, and we assign a 10% probability to this situation unfolding.

In the unlikely event this scenario does materialize, the global economy could gather significant momentum and experience growth closer to 6.75% this year, and well above trend growth of 4.5% next year. Against a backdrop where the global economy is growing in unison, financial market volatility would drop and risk assets could rally. In that sense, we would expect the U.S. dollar to outright weaken over the next three months and for emerging market currencies to outperform. Risk-sensitive G10 currencies would also perform quite well and demand for safe haven currencies would likely diminish. The longer-term prospects for the U.S. dollar would also likely deteriorate as we would expect downward pressure on the greenback to persist and dollar to weaken more than we forecast in our base case scenario. In addition, foreign currencies, led by emerging market currencies would strengthen relative to the U.S. dollar.

### Dynamic Global Growth Scenarios

The scenarios above represent our assumptions and forecasts given the information we currently have on the spread of the Delta variant and how governments have responded up to this point. Of course, health conditions and COVID related developments have the ability to change rapidly, as we saw over the course of 2020. As conditions evolve and our views on the world change, we will provide periodic updates, in addition to our monthly economic updates, on how our base case and risk scenarios change.

The below outline summarizes our forecasts in the base case scenario, and how those forecasts are likely to change in either the downside or upside risk scenario. As always, we welcome questions or comments on our outlook for the global economy and financial markets.



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