

Q4 2021 | Global Macro Outlook

Back to Goldilocks —the three bears

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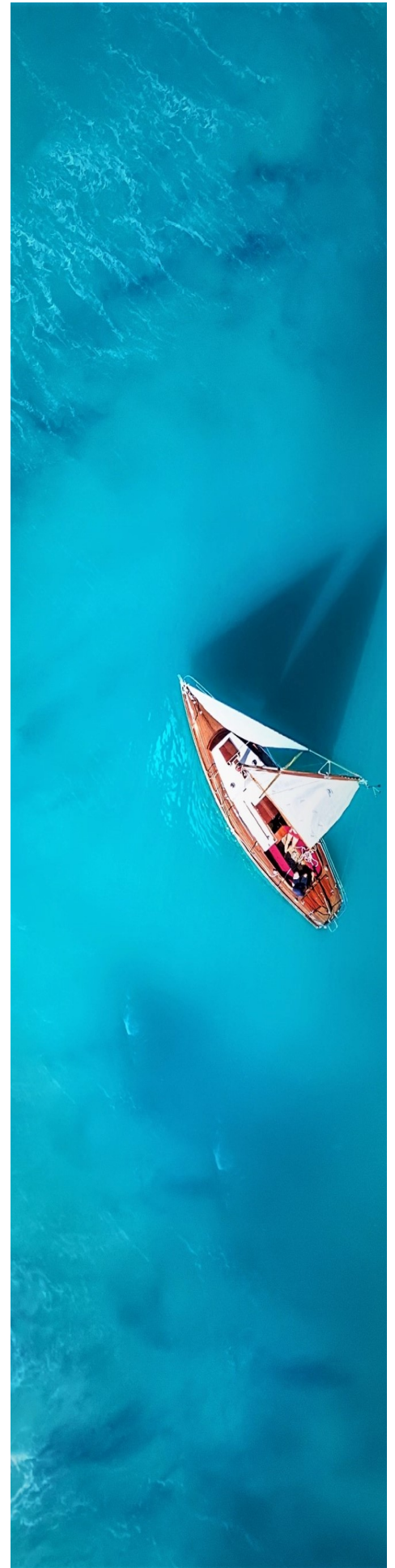
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Global overview

Big picture

Since writing about peak macro in June's edition of [Global Macro Outlook](#), global economic data has presented—as expected—upside surprises on inflation with downside surprises on growth.

Over the summer, we saw mounting evidence that supply chain disruptions were hampering growth activity and that stagflationary dynamics were at play; however, we continue to believe that inflation will moderate in 2022 and global growth will remain relatively elevated, particularly in the United States.

As we approach Q4, we believe that the worst of the stagflationary concerns have mostly been priced into the markets as upside surprises to inflation moderate and downside surprises to growth should ease.

To be clear, this has less to do with these stagflationary pressures actually moderating and more to do with the (improved) alignment of market expectations with what's really happening. We believe this to be particularly true for the United States and Europe. In our view, the market narrative will now likely shift away from stagflation to what we call a *fragile* and *transitory* Goldilocks base case in Q4.

In terms of monetary policy, while the current environment might feel a little more hawkish relative to even just a couple of months ago, we expect central banks will adopt a more dovish stance heading into year end, particularly in 2022.

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A transitory Goldilocks narrative

Broadly speaking, the main macro drivers that point us in the direction of a fragile Goldilocks narrative are:

- **Recalibrating expectations**—We expect to see a recalibration of investor expectations that should bring market consensus closer to the growth outlook for the year ahead. In other words, the market consensus should reflect a more favorable mix of growth and inflation relative to what’s already been priced by the market. While this is pretty far from the reflation trade environment that we experienced from March 2020 to May 2021, we believe it’s an environment that’s still generally positive for risk assets.
- **A slower, unsynchronized, recovery that reduces the tail risk of a boom-bust scenario in 2022**—Downgrades to the 2021 growth outlook could ironically mean potentially more support for 2022 (or, at least, we believe that’s how the market will see it).
- **Inventory rebuild**—A widely expected global inventory rebuild in the coming year is likely to support capex growth. After a protracted period of disruption, we should see pockets of improvements in some key parts of the supply chains. U.S. housing, for instance, should contribute to improving the growth picture.
- **Moving past peak COVID-19**—We believe the number of infections globally could begin to trend lower soon, notably in Asia. This could lend some support to global growth.
- **The resilient U.S. consumer**—U.S. retail spending has held up despite weak consumer confidence.
- **A U.S. labor market that appears to be healing**—Although the shortage in workers has been a source of frustration for many businesses, aggregate measures of wage growth remain muted. We expect concerns about labor supply to gradually ease in the autumn months, which should add to the perception of an improving growth outlook—specifically, one with limited inflationary pressures.

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Introducing the three bears

In our view, there remains many moving parts in the macro picture, and any number of unexpected developments could derail our thesis—which is why we call it fragile, and likely, transitory. The other thing to note is that the balance of risks remains firmly to the downside. As such, even as we continue to favor an overweight stance on equities, we're far more comfortable with defensive tilts within that positioning.

We believe that the key downside risks confronting markets can be categorized into three buckets, which we call the three bears, any of which could put an end to the fragile fairy tale pretty quickly—not least because we're already in mid- to late cycle and have also likely seen peak earnings expectations. Put differently, this is not the time for big bets. We could find ourselves back in the stagflationary regime, or a more problematic stagnation regime (declining growth and declining inflation), without warning.

Bear one: potential monetary/fiscal policy mistakes

Monetary policy—Global central banks are sounding more hawkish—U-turns from the Bank of England (BoE), policy adjustments from the European Central Bank (ECB), a Bank of Canada (BoC) that's actively tapering, and a U.S. Federal Reserve (Fed) that's set on winding down its asset purchase program. While our base-case expectation is that the market will be able to absorb these tightening measures if they're implemented gradually, it's still worth noting that:

- Global liquidity is declining, which has historically been problematic for growth
- If real interest rates climb too quickly, it can derail the equities market (as it traditionally has done), particularly as rates approach 0%
- The current environment creates scope for policy miscommunication that could create volatility in global interest rates and currency markets

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Fiscal policy—Global fiscal policy is also in tightening mode, and we believe we’re well past the point of peak fiscal support, especially in Asia and Europe. The picture isn’t too different in the United States. Heading into year end, we believe there’s ample room for headline risk related to a smaller-than-expected bipartisan infrastructure bill, potential corporate tax increases, and the growing likelihood of being faced with another debt ceiling—all of which would have an impact on the global growth outlook.

Bear two: the Delta variant and stagflation/supply shocks

While we believe the market is far more aware and sensitive to the risk of stagflationary developments (i.e., rising prices that could erode growth) than before, it still represents a material risk to global growth dynamics—particularly as major economies continue to shutter ports and place a cap on economic activity in pursuit of a zero-COVID-19 strategy. More than ever, investors should pay attention to developments on the supply side.

Meanwhile, we continue to expect headline inflation metrics to moderate in the coming year; however, high prices will continue to plague parts of the economy. Crucially, even with the best intentions, monetary policy *cannot*—and, we think, *will not*—respond to inflation that’s driven by supply-side developments. In other words, central banks such as the Fed can hike rates all they want, but higher U.S. policy rates won’t be able to help, say, Taiwan, produce more semiconductors and drive down prices. It’s an unusual situation to be caught in, and it’s one that will continue to drive a wedge between inflation data and market rates going forward. That said, the disconnect will fade as inflation moderates and market rates normalize.

“Crucially, even with the best intentions, monetary policy *cannot*—and, we think, *will not*—respond to inflation that’s driven by supply-side developments.”

Bear three: China

In our view, the downside risks in the coming quarter are most concentrated in China, where the delayed effects of policy tightening (credit, monetary, fiscal, regulatory) are likely to continue to weigh on growth, perhaps a little more than expected or had been intended. We also expect broader regulatory clampdowns to persist through 2022. Unsurprisingly, investor sentiment toward China remains negative. Crucially, we believe China isn't well positioned to tackle risks associated with a stagflationary environment. Chinese macro dynamics will continue to be an important market driver in the months ahead, although it's perhaps fair to say that investors have a better read of the situation now than they did in early 2021.

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United States

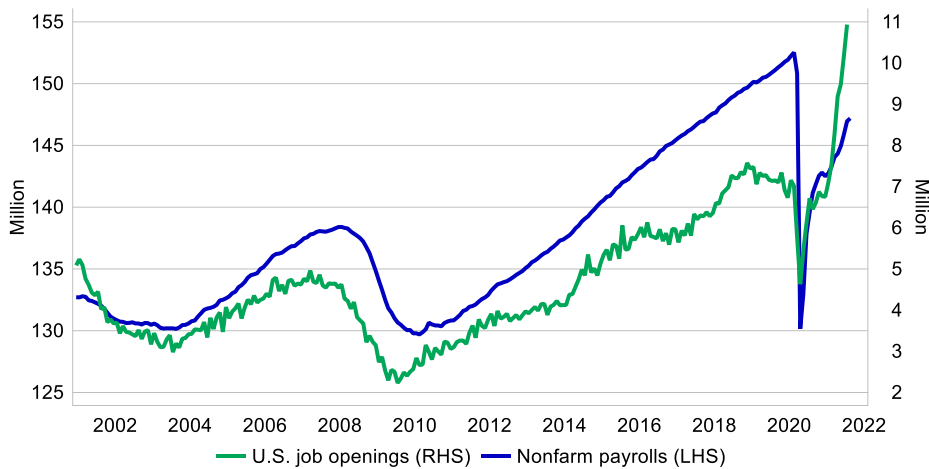
Big picture

In our view, Q3 was a transitional quarter for the U.S. economy. The dizzying growth we saw in the spring and early summer began to recede, while some of the distortions associated with that period and the pandemic lingered. Specifically, U.S. housing activity remained choppy due to both high prices and supply shortages, supply chain disruptions continued to wreak havoc, and job openings hit record levels despite clearly lower levels of overall employment.¹

Looking ahead, we see little evidence of a quick unwind in most of these areas, implying that autumn could be marked by choppy data as these trends persist. The good news is that, over the medium term, the backdrop for production, housing, and, notably, the U.S. consumer seems to be on solid footing, meaning that any uncertainty we might experience in the near term is likely to be short-lived. From a policy perspective, we maintain that the Fed will begin tapering around the end of the year but that initial interest-rate hikes won't occur before 2023.

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Job openings are at record levels, but the overall picture isn't great



Source: Bureau of Labor Statistics, Macrobond, Manulife Investment Management, as of September 21, 2021. LHS refers to left-hand side. RHS refers to right-hand side.

¹ Bloomberg, as of September 21, 2021.

What we're watching

- **Evidence of improved supply chain dynamic**—Most sources we look to for signs of a balanced economy all tell the same story: Orders are high, supplies are short, and labor is hard to find. To this end, we'll be keeping an eye on the components of business surveys and inventory levels for signs of a reversion to a more familiar semblance of normalcy.
- **Employment**—There are several angles worth keeping an eye on: labor supply shortages, progress toward full employment (especially against a backdrop of expiring enhanced unemployment benefits), and wages. These data points will be scrutinized for a full picture of the employment slack that we're seeing.

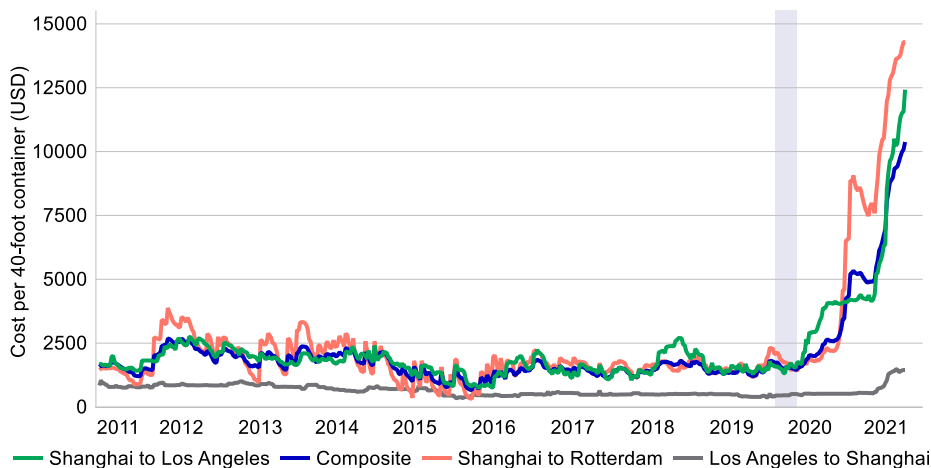
Key market views

- **Equities**—A convergence of policy uncertainty and continued choppy economic data could create market volatility in the coming quarter. While we would maintain an overweight stance on U.S. equities, it might make sense to dial down exposure to this asset class by a slight margin for now. However, given our sanguine medium-term view of the U.S. economy, we believe it makes sense to view market drawdowns as an opportunity to buy the dip.
- **Rates**—We expect U.S. 10-year yields to finish the year higher as economic data stabilizes and the Fed begins to unwind quantitative easing. Moreover, an incrementally hawkish stance from the ECB should support higher yields in Europe, which should, in turn, affect U.S. rates to the upside.

Risks to our view

Downside risk—While we don't ultimately expect it to be a factor that will significantly affect the U.S. growth outlook, uncertainty around the debt ceiling could cause volatility in October. Separately, should ongoing supply chain disruptions persist, it would continue to weigh on the economy and lead to constrained growth.

Shipping costs have skyrocketed



Source: Macrobond, Manulife Investment Management, as of September 21, 2021. The gray area represents a recession.

“Most sources we look to for signs of a balanced economy all tell the same story: Orders are high, supplies are short, and labor is hard to find.”

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Canada

Big picture

Canadian growth contracted in Q2, which coincided with another round of lockdowns, but neither the BoC nor the markets placed much emphasis on what's increasingly viewed as another transitory shock. The economy is continuing to benefit from supportive fiscal policy and, notably, solid employment gains, which are nearly back to pre-COVID-19 levels (at a much faster pace than the United States). A material weakening of the Canadian dollar (CAD) against the U.S. dollar (USD) has also helped.¹

The news isn't all good, however, as supply chain disruptions are translating into higher prices, hampering manufacturing activity. While Canada's vaccination rate is one of the highest among OECD countries,² a fourth wave of COVID-19 could bring about another lockdown, thereby placing a cap on growth. Housing activity also seems likely to slow, removing one of the larger tailwinds for growth. Meanwhile, debt levels have risen over the course of the pandemic, implying that the economy will be even more sensitive to fluctuations in interest-rate hikes.

Despite what we view as an even split of upside and downside risks, the BoC appears to have maintained a glass-half-full perspective and is likely to continue tapering its asset purchases in Q4 and unveil how it intends to reinvest proceeds from its holdings of Canadian government bonds that are due to mature. Nearly CAD\$235 billion of federal government bonds on the BoC's balance sheet are due to mature between 2022 and 2025, and of those, roughly CAD\$150 billion are due to mature in the next two years.¹

The BoC continues to expect to sustainably achieve its 2% inflation by the second half of next year,³ which the markets interpret as a hint that the first rate hike could materialize in late 2022. We continue to expect rate hikes to begin in 2023; for now, however, the BoC remains one of the most hawkish major central banks among the developed-market economies.

“The economy is continuing to benefit from supportive fiscal policy and, notably, solid employment gains, which are nearly back to pre-COVID-19 levels (at a much faster pace than the United States).”

¹ Bloomberg, as of September 21, 2021. ² OECD refers to Organisation for Economic Co-operation and Development. ³ Bank of Canada, September 8, 2021.

What we're watching

- **Housing**—Housing activity continues to be an important focal point and poses a risk to the broader outlook. Our list of concerns has grown (beyond financial stability) to include the likelihood that structurally high house prices could dampen corporate competitiveness, encourage cost-push inflation, and drive intraprovince immigration flows inside and, potentially, out of Canada—both of which could be detrimental to growth.
- **BoC**—The central bank is tapering its asset purchases (possibly because its share of the total Canadian government bond market remains around 40%³ and is therefore uncomfortably high). In our view, further adjustments to the bank's purchases need to be managed in a way that doesn't encourage unwarranted tightening or disruptions.

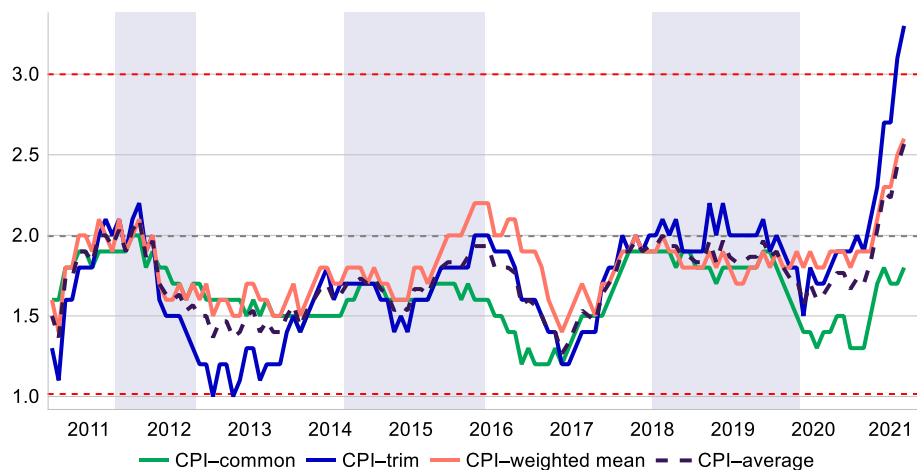
Key market views

- **Currencies**—The CAD is likely to be well supported primarily by relative central bank policy, given the BoC's more hawkish stance versus the Fed. A period of pronounced USD weakness—if it occurs—should support commodity prices and give the CAD an added lift through an improvement in Canada's terms of trade. We expect USD/CAD to trend lower, toward the 1.20 level, over the next couple of years.
- **Rates**—In our view, the market will eventually reduce its rate hike expectations in 2022 (and possibly in 2023); however, we don't expect it to occur in the next quarter, which is when Canada is likely to see sizable improvements in economic data. Therefore, Canadian rates are likely to follow the global pattern and continue to mirror movements in the U.S. bond market.

Risks to our view

- **Inflation and supply chain disruptions**—These factors could lead to higher prices and lower growth than had been expected. For now, core measures of inflation appear well anchored in the BoC's 1% to 3% target range, but stagflation remains a risk, especially if the Delta variant continues to affect global trade.
- **Policy response to the fourth wave of COVID-19**—Canada has generally pursued stricter lockdown measures in response to rising case counts. Additional social and mobility restrictions could slow growth, although to a lesser extent than in Q2.
- **Fiscal support**—Fiscal policy remains supportive relative to other developed markets; however, some income-support schemes are ending soon, which could hurt growth.

BoC's core inflation measures mostly remain within its 1% – 3% target



Source: Macrobond, Manulife Investment Management, as of September 24, 2021. The gray areas represent recessions.

³ Bank of Canada, September 8, 2021.

We believe markets will eventually need to row back their expectations for Canadian rate hikes in 2022; however, this isn't likely to happen in the next quarter, when Canadian growth is likely to continue to improve.

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Euro area

Big picture

Recent data suggests the euro area’s medium-term economic outlook is improving and faring relatively well in the face of the Delta variant. Economic data surprise indexes are showing signs of stabilization, while high-frequency growth indicators remain elevated,¹ hinting at healthy levels of growth. Inflation expectations—and forecasts—are accelerating, however, and policymakers are paying attention. Recent upside surprises to euro area inflation releases have sparked a vigorous debate at the ECB and have ultimately delivered a reduction in the pace of the Pandemic Emergency Purchase Programme that they described as a recalibration.² Markets responded with a relatively swift repricing of ECB rate expectations that also delivered a notable rise in benchmark European sovereign bond yields.¹ In our view, political risk associated with a potentially protracted German election outcome is diminished by all parties’ desire to enact aggressive green policies to help with Germany’s transition to a net-zero economy.

“Recent upside surprises to euro area inflation releases have sparked a vigorous debate at the ECB and have ultimately delivered a reduction in the pace of the Pandemic Emergency Purchase Programme that they described as a recalibration.”

Germany: 10-year break-even inflation rate (%)



Source: Macrobond, Manulife Investment Management, as of September 14, 2021. The 10-year break-even inflation rate is a market-based gauge of inflation expectations over the next 10 years.

¹ Bloomberg, as of September 14, 2021. ² [“Monetary policy decisions,”](#) European Central Bank, September 9, 2021.

What we're watching

- Inflation and the ECB—** Policymakers are responding to inflation with a recalibration in the pace of asset purchases; however, markets are also repricing the trajectory of the eurozone's interest rate, expecting rate hikes to occur sooner. That said, financial conditions remain a key concern.
- German election outcome—**It's widely accepted that the election, which took place in September, was highly unlikely to deliver an immediately conclusive result because coalition negotiations typically take several months. Broad-based agreement on an aggressive green agenda is likely to deliver a permanent departure from the black zero fiscal framework.³

Key market views

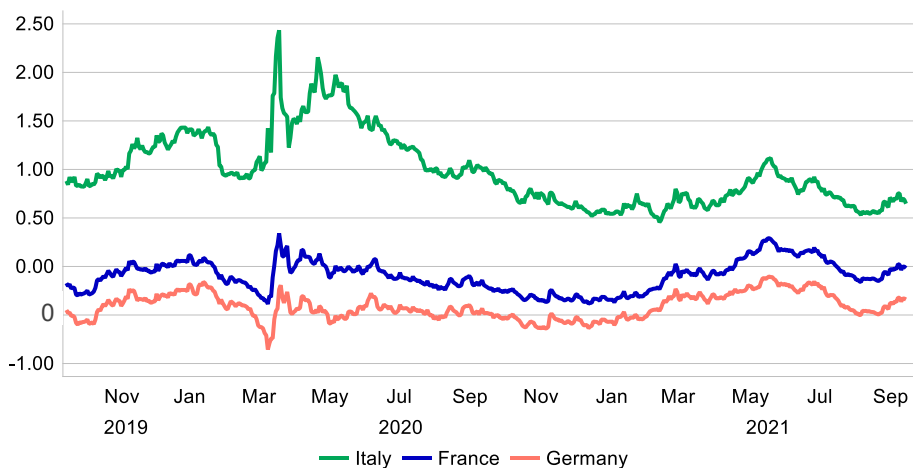
- Rates—**In our view, the evolution of the ECB's plans for its balance sheet is likely to offer support to benchmark European bond yields over the next several quarters. We also believe that the movements in German yields can carry spillover risk, most notably to U.S. yields.
- Currencies—**The sooner-than-anticipated taper discussion at the ECB has delivered a much-needed stabilization in the euro (EUR), particularly against the USD. We remain medium/longer-term EUR/USD bulls and expect the currency pair to rise above the 1.25 mark and head toward the 1.30 level over the next couple of years.

“The ECB’s policy normalization could pose a critical risk to the progression of the recovery and must be managed carefully.”

Risks to our view

- Financial conditions—**The ECB's policy normalization could pose a critical risk to the progression of the recovery and must be managed carefully. In our view, the recalibration of the ECB's pace of asset purchases must be divorced from the rate hike discussion in order for the bank to maintain favorable financial conditions.
- Political risk—**Coalition negotiations in Germany could take at least a couple of months and possibly extend well into 2022. The French presidential election scheduled for Q2 2022 is another potential source of geopolitical risk; however, data suggests much of this has already been priced into the currency market.

Benchmark 10-year European bond yields (%)



Source: Macrobond, Manulife Investment Management, as of September 15, 2021.

³ Schwarze null, or black zero, refers to Germany's self-imposed fiscal rule, which insists that fiscal spending must be balanced by tax receipts.

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United Kingdom

Big picture

The U.K. growth outlook remains relatively solid, with consensus estimates hovering in the 5% to 6% range for both 2021 and 2022. The reopening has been challenged by the emergence of the Delta variant, and the services sector remains hampered by a sense of caution among consumers even in the absence of renewed restrictions. Nevertheless, Q2 GDP was bolstered by a better-than-expected contribution from consumption, and spending appears to be stabilizing at healthy levels. The evolution in thinking among policymakers at the BoE remains impressive as they seek to firm expectations around interest-rate hikes and are even paving the way for monetary tightening through changes to the composition of the bank's balance sheet. The recent announcement of fiscal consolidation has largely been digested, given its minimal size.¹

“The evolution in thinking among policymakers at the BoE remains impressive as they seek to firm expectations around interest-rate hikes and are even paving the way for monetary tightening through changes to the composition of the bank’s balance sheet.”

U.K. 10-year break-even inflation rate



Source: Bloomberg, Manulife Investment Management, as of June 10, 2021. The 10-year break-even inflation rate is a market-based gauge of inflation expectations over the next 10 years.

¹ [“Record £36 billion investment to reform NHS and Social Care,” gov.uk, September 7, 2021.](#)

What we're watching

- **Inflation**—U.K. inflation breakevens have climbed to fresh 13-year highs, reaching levels last sustainably seen in the early/mid-1990s.² Consensus estimates for official Consumer Price Index (CPI) figures are also being upgraded significantly. In our view, this represents a challenge for the BoE, which will likely need to maintain a level of hawkishness in its response.
- **Fiscal developments**—We'll be watching the autumn budget closely, scheduled for late October, given U.K. Prime Minister (PM) Boris Johnson's recently announced healthcare and social spending measures,¹ which are planned to be funded through income-tax hikes. Funded spending marks a clear departure from the United Kingdom's recent fiscal policy, and the evolution is notable.

Key market views

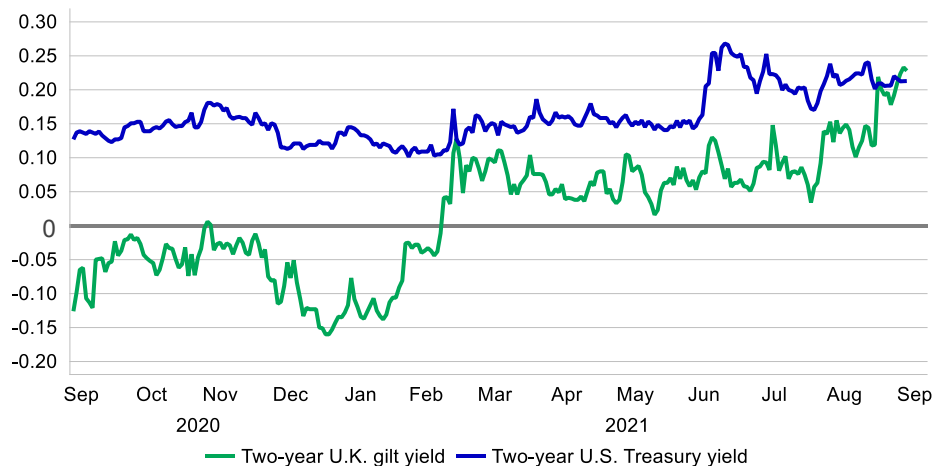
- **Currencies**—In our view, the pound sterling (GBP) appears set to strengthen on both a relative (nominal, vs. the USD and the EUR) and absolute (real effective exchange rate) basis following two quarters of consolidation. From a technical perspective, GBP/USD appears to be in the early stages of a breakout and EUR/GBP has once again rolled over, suggesting that the EUR could push below the post-COVID-19 lows from August against the GBP.
- **Rates**—U.K. yields broke above U.S. yields in late Q3.² The outlook of major global central banks suggests their likely approach to monetary policy in the near term is likely to be supportive of U.K. yields as the BoE remains the most hawkish, particularly relative to the Fed, the ECB, and the Bank of Japan (BoJ).

“In our view, the GBP appears set to strengthen on both a relative (nominal, vs. the USD and the EUR) and absolute (real effective exchange rate) basis following two quarters of consolidation.”

Risks to our view

Central bank policy normalization—The BoE is in the process of executing what we perceive to be an astounding hawkish U-turn, given that the bank's Monetary Policy Committee members had been communicating a relatively dovish outlook well into Q2. The introduction of the idea of medium-term balance sheet tightening³ is a new development and may pose a threat to financial conditions as market participants price in an unwind of quantitative easing stimulus.

Two-year yields: U.K. vs. U.S. (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of September 13, 2021.

¹ “Record £36 billion investment to reform NHS and Social Care,” gov.uk, September 7, 2021.

² Bloomberg, as of September 13, 2021. ³ “Bank Rate Maintained at 0.1%—August 2021,” Bank of England, August 5, 2021.

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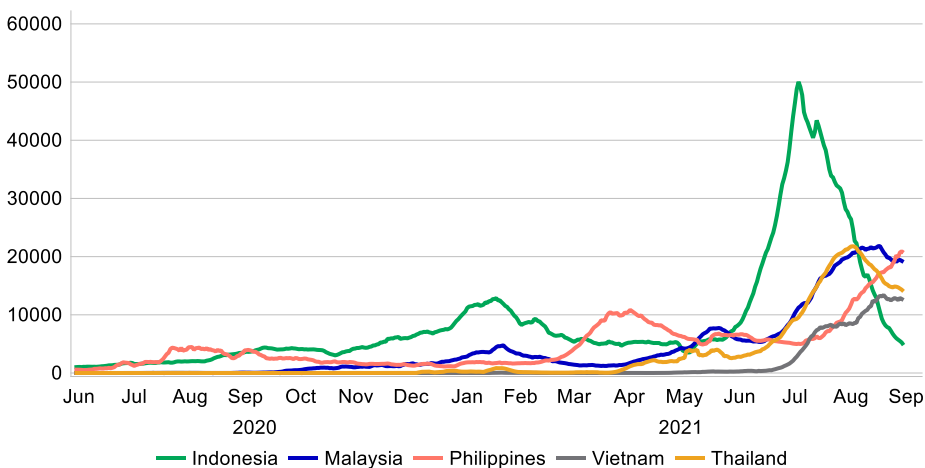
Emerging Asia

Big picture

Asia’s economic outlook continues to hinge on the course of the pandemic. Recent COVID-19 outbreaks appear to be easing across Southeast Asia.¹ Indonesia, in particular, has seen a strong improvement. On the back of this positive development, Indonesia, Thailand, and Malaysia have begun to relax restrictions, and our mobility data shows that people movement in the region is recovering in earnest.² Strong foreign demand for the region’s exports has cushioned disruptions to domestic demand; governments have also responded to the recent outbreak with more stimulus measures, albeit in varying degrees, thereby amplifying the unevenness of the recovery. Worryingly, many governments forecast net fiscal tightening across the 2020/2023 period, which would leave the onus of supporting the economic recovery on central banks, and we expect interest rates to remain low across the region for some time to come.

“Worryingly, many governments forecast net fiscal tightening across the 2020/2023 period, which would leave the onus of supporting the economic recovery on central banks, and we expect interest rates to remain low across the region for some time to come.”

COVID-19: confirmed cases



Source: World Health Organization, Macrobond, Manulife Investment Management, as of September 15, 2021.

¹ World Health Organization, as of September 24, 2021. ² Google’s COVID-19 Community Mobility Report, Macrobond, Manulife Investment Management, as of September 15, 2021.

What we're watching

- **COVID-19 trends**—Daily deaths and case counts appear to have peaked in earnest, but absolute numbers remain elevated. In our opinion, improvement in the vaccination rate will be key to recovery in the services sector and tourism.
- **Fed communication**—As we enter a period of uncertainty regarding the timing of the Fed's expected plan to reduce its asset purchasing program, potential volatility in the USD and U.S. interest rates may weigh on global liquidity—an element that's crucial to Asian growth.

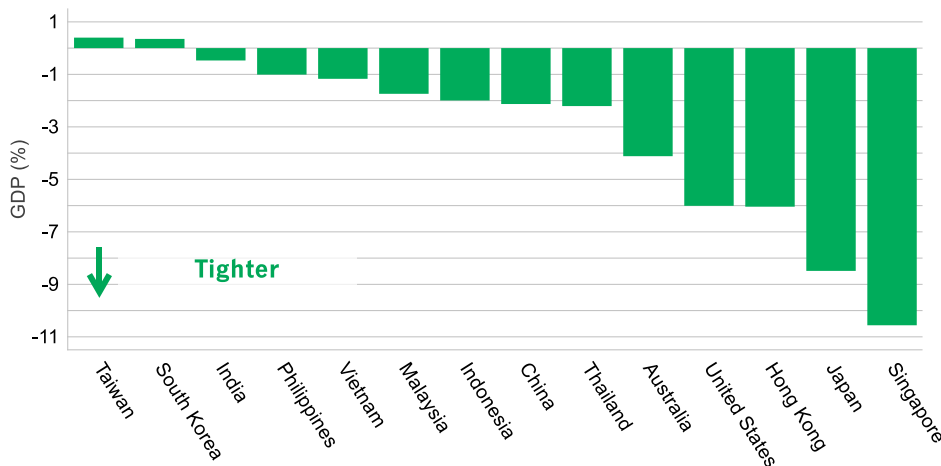
Key market views

- **Equities and rates**—We think emerging Asia equities and fixed income will be supported by accommodative monetary policy stances and are, broadly speaking, in a better position to withstand Fed taper risks relative to 2013 thanks to stronger external positions, lower reliance on external funding, and better-balanced positioning. We see the scope for economic growth catching up in parts of Southeast Asia as COVID-19 concerns ease.
- **Foreign exchange**—With the USD finding some support now that U.S. real yields seem to have hit a bottom, there may be increasing headwinds to Asian currencies.³

Risks to our view

- **Upside risk**—Vaccination rates aren't stable, but we believe a ramp up in the pace of inoculation would pave the way to a faster economic reopening.
- **Downside risk**—Asian exports held up well despite the global supply chain disruption because producers were able to run down elevated inventory. With that buffer depleted, prolonged supply shortages will likely be felt more acutely.

Net fiscal impulse: 2020–2023



Source: Macrobond, Manulife Investment Management, as of September 15, 2021. Fiscal impulse refers to the change in the government budget balance due to changes in government expenditure and tax policies.

³ Bloomberg, as of September 15, 2021.

“We think emerging Asia equities and fixed income will be supported by accommodative monetary policy stances and are, broadly speaking, in a better position to withstand Fed taper risks relative to 2013 thanks to stronger external positions, lower reliance on external funding, and better-balanced positioning.”

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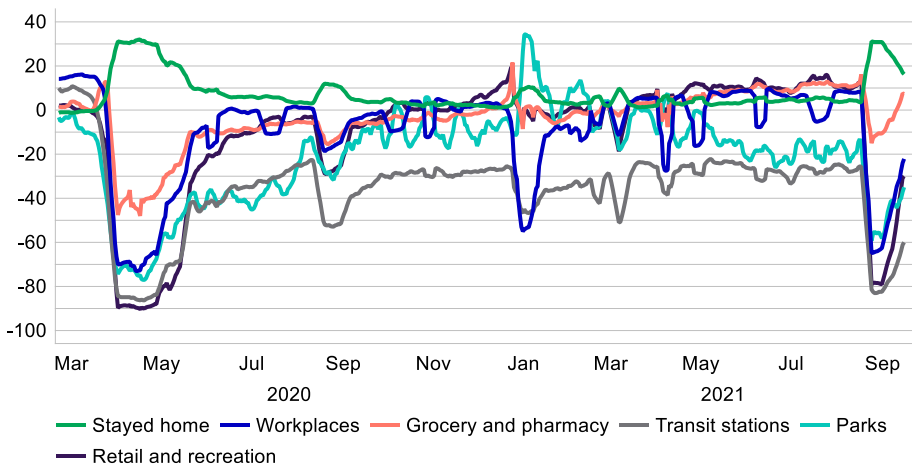
Australia/New Zealand

Big picture

Both Australia and New Zealand (NZ) have been hit by their worst COVID-19 outbreak since the pandemic started. The current strategy in Australia is to ease lockdowns when 70% of the population is inoculated and to start opening international borders when 80% is vaccinated.¹ At current rates, 70% will be vaccinated in Australia by the end of November, meaning another 2.5 months of lockdowns. Meanwhile, NZ’s vaccination rollout lags Australia. While the NZ government hasn’t explicitly stated its preconditions for a broad economic reopening, at the current rate of vaccination, it will reach 70% inoculation in mid-December and 80% in early January 2022.² Unsurprisingly, data shows that mobility levels in NZ are below Australia.³

“The current strategy in Australia is to ease lockdowns when 70% of the population is inoculated and to start opening international borders when 80% is vaccinated.”

Mobility level in New Zealand relative to baseline (%)



Source: Google’s COVID-19 Community Mobility Report, Manulife Investment Management as of September 12, 2021. The baseline is the median value for the corresponding day of the week during the five-week period between January 3, 2020, and February 6, 2020.

¹ “Roadmap to freedom unveiled for the fully vaccinated,” nsw.gov.au, September 9, 2021. ² Manulife Investment Management, as of September 12, 2021. ³ Google’s COVID-19 Community Mobility Report, University of Oxford, as of September 12, 2021.

What we're watching

- **COVID-19 and vaccine trends**—A speedy vaccination rollout is seen by the governments as the pathway to reopening and getting back to normal.
- **Sustainability of the divergence in monetary policy**—Monetary policy stances in the two countries have diverged, moving in the opposite direction of COVID-19 and vaccination trends—the Reserve Bank of Australia (RBA) reduced bond purchases in September but extended its bond purchase program until at least mid-February 2022. The decision was seen as a dovish taper.⁴ Meanwhile, the Reserve Bank of New Zealand (RBNZ) has expressed a strong conviction to get its policy rate above the neutral level of 2.0% quickly⁵ and reiterated its view that “house prices appear to be above their sustainable level.”⁶

Key market views

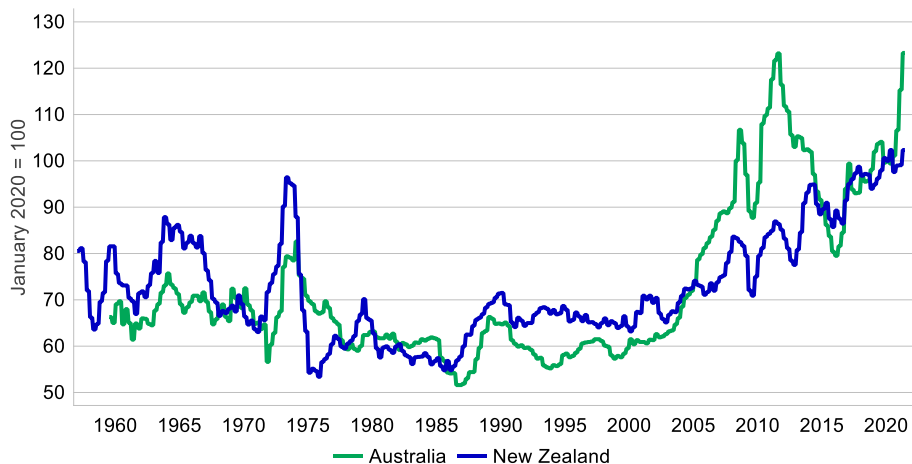
Currencies and rates—We're expecting to see outperformance in AUD/NZD, Australian bonds, and swaps. With almost three full 25 basis point (bps) rate hikes priced for the next three RBNZ meetings (October, November, February),⁷ we see limited scope for NZD to extend its outperformance or NZ bonds and swaps to extend their underperformance. Relative terms of trade also suggest that some reversal of last quarter's price action could be likely.

“The RBNZ is already forecasting tight labor market conditions, yet the RBA doesn't yet think the labor market will be tight enough to generate wage growth sufficient to sustain inflation within the 2% to 3% target band until 2024 at the earliest.”

Risks to our view

Upside and downside risks will be dependent on the pace of recovery in the labor markets—Both markets are dependent on the free flow of international labor to keep wage inflation low. Prolonged border controls would increase capacity pressures and exert upward pressure on wage inflation. The RBNZ is already forecasting tight labor market conditions,⁶ yet the RBA doesn't yet think the labor market will be tight enough to generate wage growth sufficient to sustain inflation within the 2% to 3% target band until 2024 at the earliest.⁴ Relative risks here also support our key market views.

Terms of trade



Source: Australia Bureau of Statistics, StatsNZ, Bloomberg, Macrobond, Manulife Investment Management, as of September 12, 2021.

⁴ Reserve Bank of Australia, September 7, 2021. ⁵ “Orr Says Next RBNZ Meeting ‘Live’ Even if Outbreak Persists,” bloomberg.com, August 19, 2021. ⁶ Reserve Bank of New Zealand, August 19, 2021. ⁷ Bloomberg, as of September 12, 2021.

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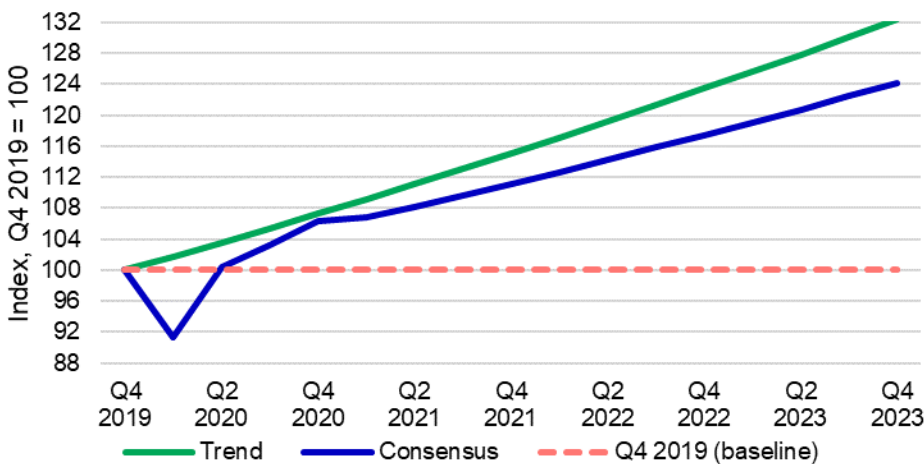
China

Big picture

A string of negative surprises in activity data has led to a narrowing in consensus expectations for China’s GDP differentials. As headline growth rates remain distorted by base effects from last year’s COVID-19 downturn, it makes sense to focus on a longer horizon that captures the loss of output in 2020 and the extent to which expected recoveries in 2021 and 2022 will offset the economic damage. On this basis, China has seen only modest revisions since September 2020.¹ The usual lag between policy implementation and impact means recent policy tightening—monetary, fiscal, credit, and regulatory—is likely to become a more forceful drag later this year. In our view, regulatory tightening will continue until at least the Party Congress in late 2022.

“The usual lag between policy implementation and impact means recent policy tightening—monetary, fiscal, credit, and regulatory—is likely to become a more forceful drag later this year.”

China: consensus forecast vs. pre-COVID-19 trend



Source: Bloomberg, Manulife Investment Management, as of September 15, 2021. Indexed to 100, using Q4 2019 as the baseline.

¹ Bloomberg, as of September 15, 2021.

What we're watching

- **Broader clampdowns**—In our view, the recent regulatory changes appear to be ideologically driven—economic efficiency and productivity might not be key priorities.
- **Fed communication**—As we enter a period of uncertainty regarding when the Fed will begin to scale down its asset purchases, we could see potential volatility in the USD and U.S. interest rates, which will likely further tighten USD liquidity and affect China's growth prospects.

Key market views

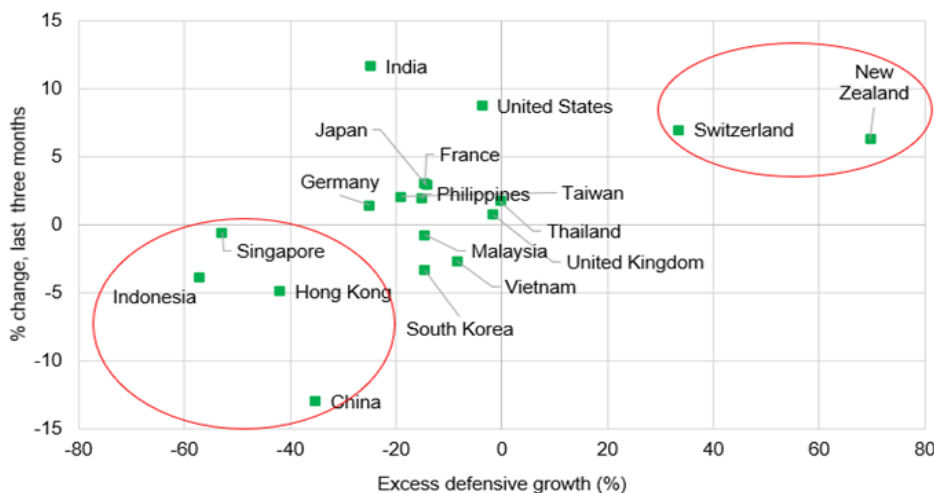
Equities—Investor sentiment remains negative amid elevated regulatory risk and the limited hedge against likely stagflation based on the composition of the MSCI China Index.

“As we enter a period of uncertainty regarding when the Fed will begin to scale down its asset purchases, we could see potential volatility in the USD and U.S. interest rates, which will likely further tighten USD liquidity and affect China's growth prospects.”

Risks to our view

- **Upside risk**—Barriers to entry could protect Chinese companies from foreign competition and a possible sudden surge in interest from global equity investors as a result of perennial underallocation to China's A-shares. This would provide much-needed USD liquidity to fuel Chinese economic growth.
- **Downside risk**—An unplanned overshoot in policy tightening and a much faster-than-anticipated slowdown in the property sector could emerge as a risk to China's economic outlook.

Excess stagflation seems to explain performance (%)



Source: MSCI, Macrobond, Manulife Investment Management, as of September 15, 2021. Excess defensive growth is calculated by subtracting the total share of the financials, information technology, consumer discretionary, and real estate sectors from the total share of defensive sectors—consumer staples, healthcare, materials, industrials, and utilities—from MSCI country indexes.

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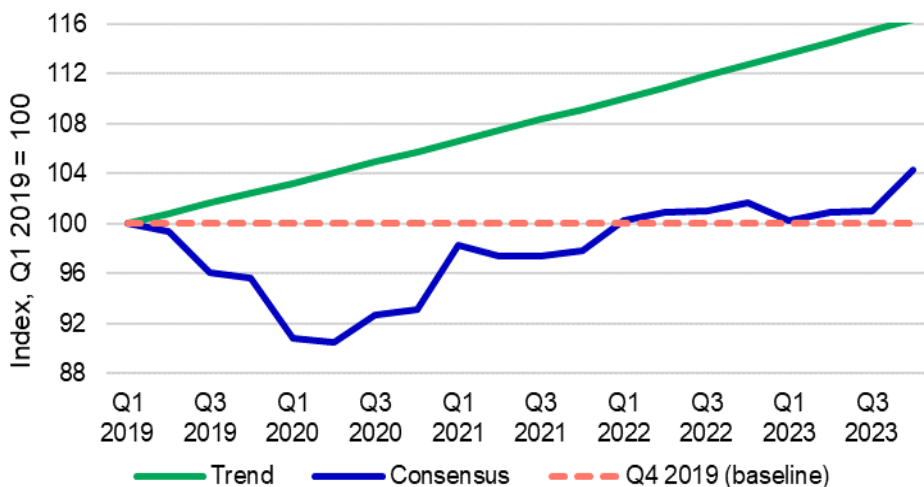
Hong Kong

Big picture

Mobility data shows that Hong Kong has weathered domestic COVID-19 disruptions better than most other economies in the Asian region.¹ The most recent COVID-19 wave peaked in December 2020, and Hong Kong’s vaccination rate picked up sharply in the third quarter. At the current rate of vaccination, 80% of the population in Hong Kong could be fully vaccinated sometime in November. That said, international border restrictions remain relatively tight—in our view, a full and lasting recovery will only be possible once borders reopen and tourists return. As such, economic growth will be reliant on domestic consumption going into the end of the year. Encouragingly, consumers have been supported by the government’s Hong Kong dollar (HK\$) 5,000 consumption voucher scheme for permanent residents, but there’s a lot of work to do to close the GDP gap that’s opened up since 2019. Based on current consensus forecasts, Hong Kong’s GDP in the next two years will likely remain ~12% below the GDP trend that prevailed before the domestic protests began in 2019.

“Based on current consensus forecasts, Hong Kong’s GDP in the next two years will likely remain ~12% below the GDP trend that prevailed before the domestic protests began in 2019.”

Hong Kong: consensus forecast vs. pre-COVID-19 trend



Source: Macrobond, Manulife Investment Management, as of September 15, 2021. Indexed to 100, using Q1 2019 as the baseline.

¹ Google COVID-19 Community Mobility Report, as of September 15, 2021.

What we're watching

- **Mainland border**—The city's Come2hk scheme was launched in mid-September, allowing 2,000 nonresidents to arrive from mainland China daily without needing to quarantine.² However, China has yet to announce a reciprocal arrangement.
- **Emigration trends**—As borders in the rest of the world are relaxing at a quicker rate, the recent jump in emigration suggests the city may have to wrestle with a potential brain drain issue further down the road.³

Key market views

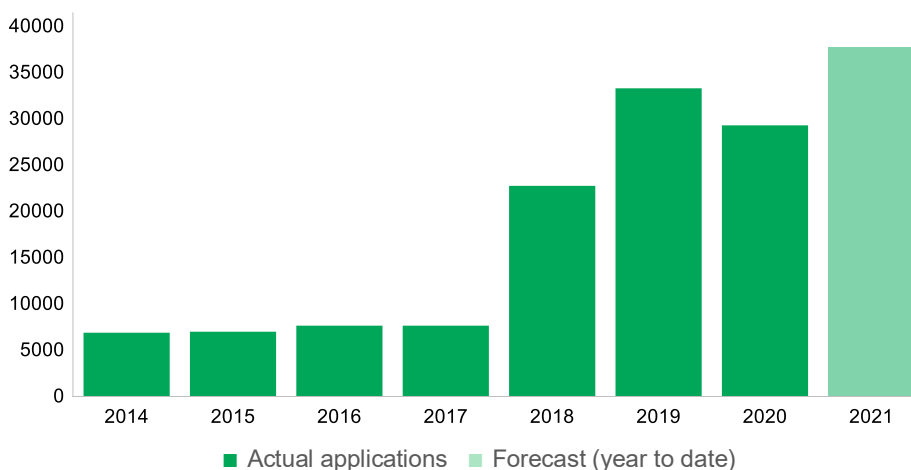
Equities—We expect the Hang Seng China Enterprises Index to underperform the main Hang Seng Index and believe the Hang Seng Index will underperform the Shanghai Shenzhen CSI 300 Index on the back of continued China trade slowdown (including tourism), deglobalization, and heightened political risks. In our view, onshore investors will remain net sellers of Hong Kong stocks through the Southbound Stock Connect channel.

“Consumption recovery could extend with the second installment of consumption vouchers worth HK\$21.6 billion, or 6.6%, of the 2020 retail sales value.”

Risks to our view

- **Upside risk**—Consumption recovery could extend with the second installment of consumption vouchers worth HK\$21.6 billion, or 6.6%, of the 2020 retail sales value.⁴
- **Downside risk**—Limited takeup to Come2hk due to the asymmetric border reopening and prevailing caution on the mainland are two factors that could hinder Hong Kong's economic outlook.

Annual application to certify absence of criminal records (for emigration)



Source: Macrobond, Manulife Investment Management, as of September 15, 2021.

² “Come2hk travel scheme to open,” news.gov.hk, September 14, 2021. ³ Macrobond, as of September 15, 2021. ⁴ Manulife Investment Management, September 15, 2021.

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India

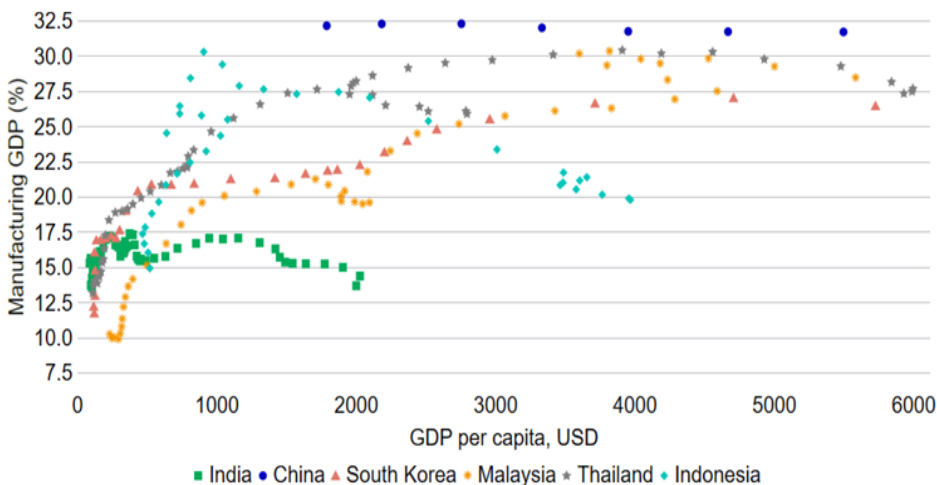
Big picture

As the pandemic displays signs of stabilizing, economic activity in India is starting to inflect higher. Meanwhile, inflation appears to have peaked and could fall below the Reserve Bank of India’s (RBI’s) upper bound. We expect the RBI to maintain its accommodative monetary policy for some time yet.

The big development in Q3 was on the fiscal front. Following what was, in our view, a game changing budget earlier this year, the government announced a National Monetisation Pipeline in August worth ~2.6% of its GDP.¹ This demonstrates the government’s commitment to building long-term economic resilience by raising infrastructure spending, boosting domestic industry, improving efficiency, and achieving higher productivity. We believe the structural growth story for India remains intact and that the elusive recovery could be around the corner.

“We believe the structural growth story for India remains intact and that the elusive recovery could be around the corner.”

India manufacturing has underperformed its Asian peers



Source: Macrobond, Manulife Investment Management, as of September 9, 2021.

¹ “National Monetisation Pipeline,” india.gov.in, August 23, 2021.

What we're watching

Domestic factors—With the latest COVID-19 wave seemingly under control for the time being, focus turns to domestic factors that have been holding back the recovery to date. A major headwind has been the weakness of the banking sector—bank lending growth has remained very subdued over the past year. Another factor is consumer demand, which has slowed sharply since late last year. In addition, consumer sentiment remains well below prepandemic levels.²

Key market views

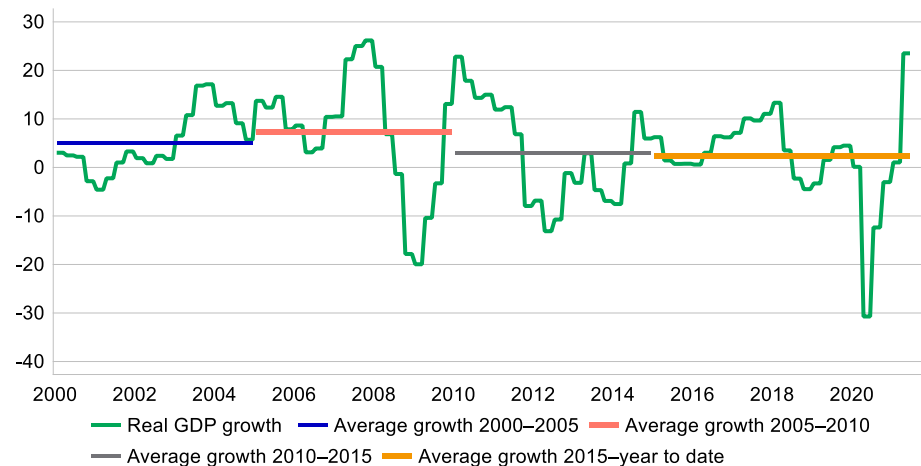
Rates and equities—We expect Indian equities and government bonds to outperform; however, in our view, the India rupee will underperform. With monetary policy normalization likely to take place very gradually in the coming years, we expect government bond yields in India to rise only marginally over the medium term and, crucially, by less than most other emerging markets. We expect that will promote currency underperformance and equity outperformance.

“With the latest COVID-19 wave seemingly under control for the time being, focus turns to domestic factors that have been holding back the recovery to date.”

Risks to our view

Upside and downside risks—States could loosen COVID-19-related restrictions quicker than expected, presenting a key upside risk to near-term economic activity. Meanwhile, a slow vaccine rollout means that rapid reopening would increase the threat of renewed virus outbreaks, potentially with more contagious variants. In our view, a faster initial recovery could come at the cost of a relapse further ahead.

India GDP growth: average growth has been trending lower YoY (%)



Source: World Bank, Macrobond, Manulife Investment Management, as of September 9, 2021. YoY refers to year over year.

² Macrobond, September 9, 2021.

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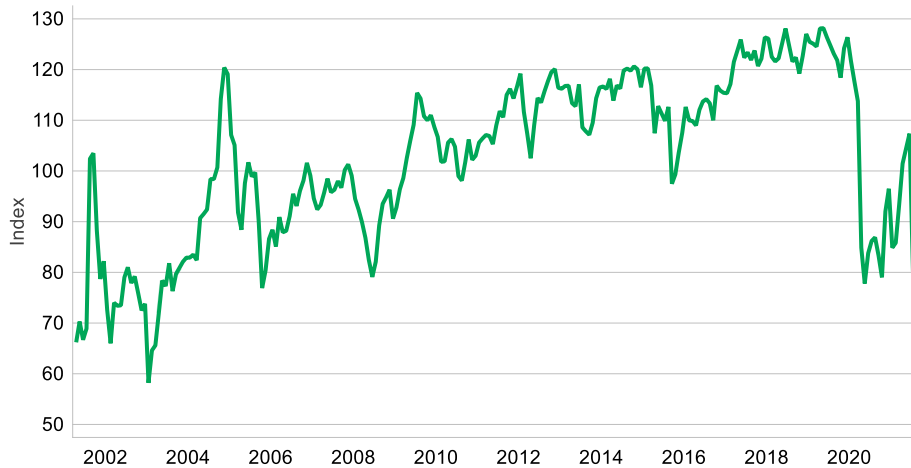
Indonesia

Big picture

Economic activity is starting to recover in Indonesia as the COVID-19 outbreak eases slightly, albeit from depressed levels. Indeed, consumer confidence fell to a 16-year low, hurt by concerns about job availability, income, and the affordability of durable goods.¹ Looking ahead, the Indonesian government has targeted a 70% COVID-19 inoculation rate by the end of this year,² which would be much quicker than the current rate. If realized, this could be a positive catalyst for a stronger recovery. The biggest development in the last quarter was Bank Indonesia’s (BI’s) announcement of a return to burden-sharing arrangements through the end of 2022 to help with pandemic relief measures.³ While the development’s in line with our expectations, this was a surprise to the market, which didn’t anticipate an extension of the program.

“The biggest development in the last quarter was BI’s announcement of a return to burden-sharing arrangements through the end of 2022 to help with pandemic relief measures.”

Indonesia: Consumer Confidence Index



Source: Bank Indonesia, Macrobond, Manulife Investment Management, as of September 9, 2021.

¹ Bank Indonesia, September 8, 2021. ² [“Indonesia caught between surge and slow vaccine rollout,”](#) apnews.com, July 3, 2021. ³ [“Govt. BI approve \\$30b burden-sharing scheme,”](#) thejakartapost.com, August 25, 2021.

What we're watching

- **COVID-19 trends**—The evolution of the pandemic, high-frequency mobility data, the pace of vaccine rollouts, and updates on social distancing measures continues to warrant monitoring.
- **U.S. real yields**—A continued rise in U.S. real yield could leave Indonesia vulnerable in the region—it's the only Asian economy that's running a current account deficit (on a four-quarter moving average basis),⁴ which leaves it beholden to foreign bond inflows.

Key market views

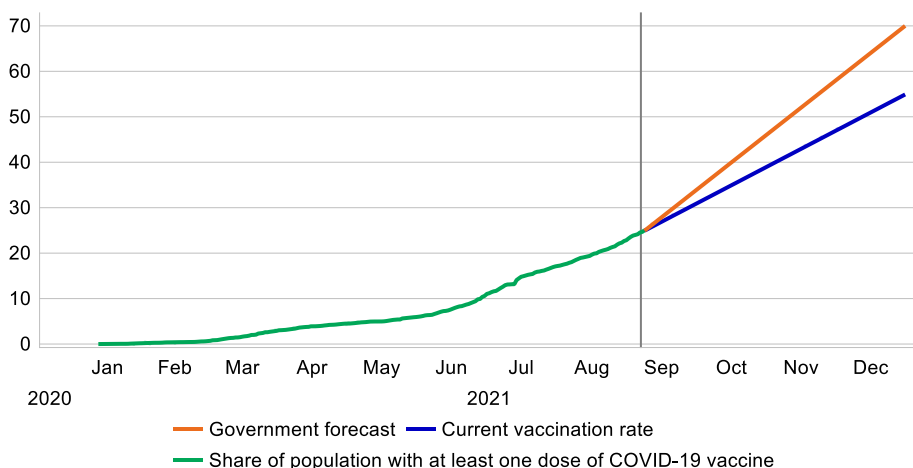
Rates, equities, and currencies—We expect Indonesia government bonds and equities to outperform; however, the Indonesian rupiah will likely underperform. In our view, BI will need to lean against high real yields.

“A continued rise in U.S. real yields could leave Indonesia vulnerable in the region—it's the only Asian economy that's running a current account deficit (on a four-quarter moving average basis), which leaves it beholden to foreign bond inflows.”

Risks to our view

- **Upside risk**—A quicker-than-expected improvement in COVID-19 case counts and vaccinations, accompanied by a relaxation of social distancing measures, could help support sentiment and a faster return to some semblance of normalcy.
- **Downside risk**—Credit growth remains depressed, and government expenditure remains limited. For as long as that remains to be the case, the economic recovery will likely be much slower.

Indonesia: population with at least one dose of COVID-19 vaccine (%)



Source: Our World in Data, Macrobond, Manulife Investment Management, as of September 9, 2021.

⁴ Bloomberg, September 8, 2021.

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Japan

Big picture

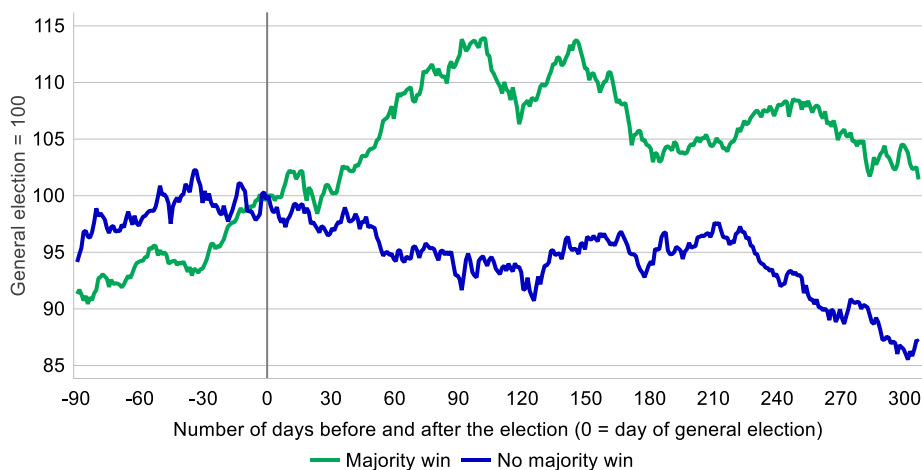
A confluence of developments has boosted investor sentiment toward Japan in the past month. Among them, arguably the most important, was PM Yoshihide Suga's surprise announcement that he wouldn't be running for reelection as president of the ruling Liberal Democratic Party (LDP) when it holds its leadership election at the end of October.

Optimism is high that PM Suga's successor will pave the way for faster fiscal policy momentum and less draconian measures to contain the COVID-19 outbreak. Expectations for economic reopening are also on the rise.¹

The latest COVID-19 wave peaked in late August with the daily case count falling quickly. Meanwhile, vaccination rollout has accelerated, and over half the population is now fully vaccinated,² setting the scene for a cyclical economic recovery.

“Optimism is high that PM Suga’s successor will pave the way for faster fiscal policy momentum and less draconian measures to contain the COVID-19 outbreak.”

TOPIX Index: returns before and after general elections



Source: Macrobond, Manulife Investment Management, as of September 15, 2021.

¹ “Japan’s Nikkei index touches 30,000 on post-Suga hopes,” asia.nikkei.com, September 7, 2021. ² Our World in Data, as of September 16, 2021.

What we're watching

Politics—The general election of the House of Representatives is scheduled on or before November 28 and will likely be in the first half of the month. Expectations are high that the LDP will once again return with a majority along with its junior coalition partner, Komeito.³ Historically, expectations of a majority government that are realized tend to lead to a stronger performance in Japanese equities in the lead-up to and three to five months after the general election before losing momentum. In the event that none of the political parties emerges with a majority, the stock market has historically weakened quickly. That said, a relatively large share of undecided voters in polls could mean polls aren't as representative as they seem. A narrower LDP majority could potentially impede structural reform efforts, denting investor sentiment earlier than expected.

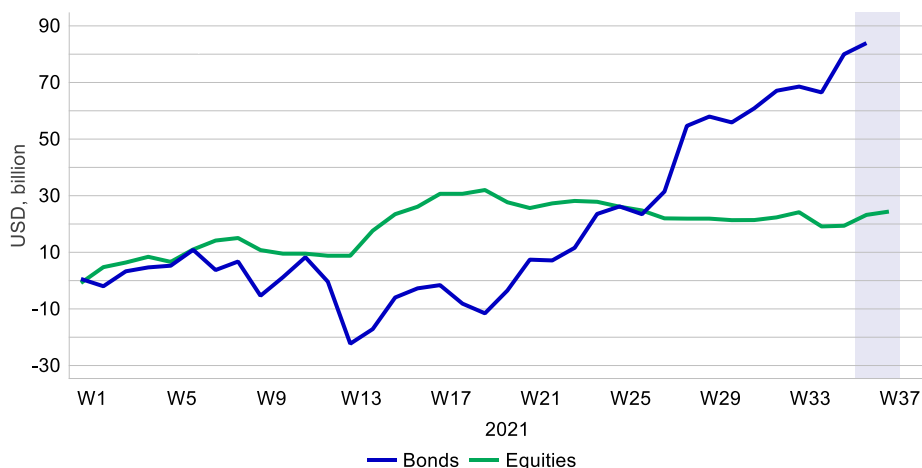
Key market views

- **Equities**—We expect Japanese equities to outperform. The asset class is generally undervalued versus its global peers, and we foresee support for Japanese stocks coming from the economic reopening. Given the structurally underweight foreign investor positioning in the asset class, the upcoming general election could encourage greater participation from foreign investors in the next few months based on historical patterns. Finally, historical data shows that Japan equities typically outperform when global liquidity falls.
- **Currencies and rates**—We expect the Japanese yen and government bond to outperform in the near term as investors turn to them as a hedge against stagflationary risks.

Risks to our view

- **Upside risk**—A strong fiscal package would offset the net fiscal tightening currently forecast across 2020/2023, turning fiscal policy from an economic headwind to a tailwind to growth.
- **Downside risk**—All the main candidates hoping to replace PM Suga have indicated that they're in favor of increasing the level of taxation of investment income. While this is unlikely to be realized immediately, in our view, it would be a negative catalyst for equities.

Net foreign investment in Japan portfolio securities year to date



Source: Ministry of Finance (Japan), Macrobond, Manulife Investment Management, as of June 10, 2021. The grey area represents a recession. W refers to week of the year.

³ "Japan likely to have general election in 1st half of November," english.kyodonews.net, September 12, 2021.

“A strong fiscal package would offset the net fiscal tightening currently forecast across 2020/2023, turning fiscal policy from an economic headwind to a tailwind to growth.”

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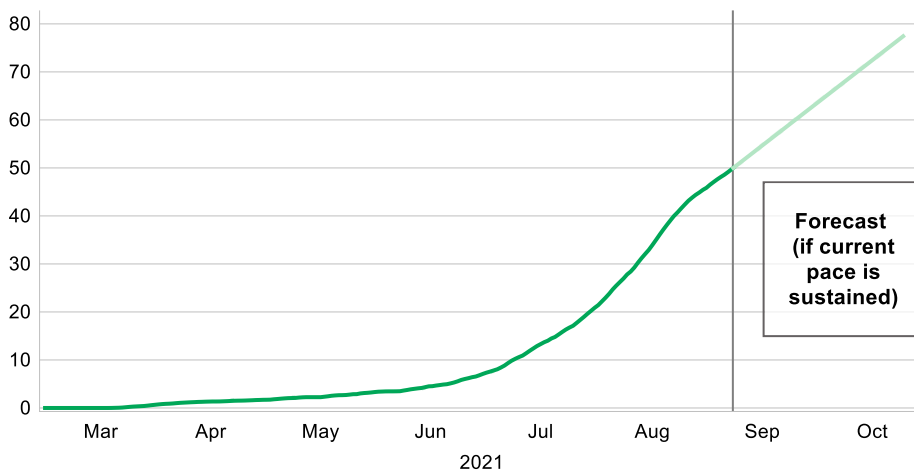
Malaysia

Big picture

Since announcing a nationwide lockdown on May 12, the government has begun rolling back restrictions. Mobility is recovering, but it remains at a depressed level. The good news is that the COVID-19 vaccine rollout has developed considerable momentum—as of this writing, just under 60% of the country’s population is fully vaccinated, and if the current pace is maintained, the vaccination rate will likely exceed 70% in October.¹ Daily COVID-19 cases in the current wave also appear to have peaked. We think Malaysia has reached an inflection point and is about to enter a cyclical recovery after contracting 2% in Q2 from the previous quarter.² We expect economic policies to remain accommodative, considering the country’s economic output is likely to remain below potential for some time to come.

“We think Malaysia has reached an inflection point and is about to enter a cyclical recovery after contracting 2% in Q2 from the previous quarter.”

Malaysia: population with at least one dose of COVID-19 vaccine (%)



Source: Our World in Data, Macrobond, Manulife Investment Management, as of September 9, 2021.

¹ Our World in Data, as of September 24, 2021. ² Department of Statistics Malaysia, August 13, 2021.

What we're watching

- **Politics**—In August, Ismail Sabri Yaakob was appointed as Malaysia's third PM in three years.³ In our view, the appointment doesn't necessarily mark the end of political uncertainty since PM Ismail only has a four-seat majority in a 222-seat Parliament.⁴
- **COVID-19 deaths**—While the number of daily confirmed infection cases appears to have peaked, deaths attributed to the virus continue to rise. Given the amount of lead time needed to ascertain whether those infected will recover, we expect the death rate to come down in the next few weeks.

Key market views

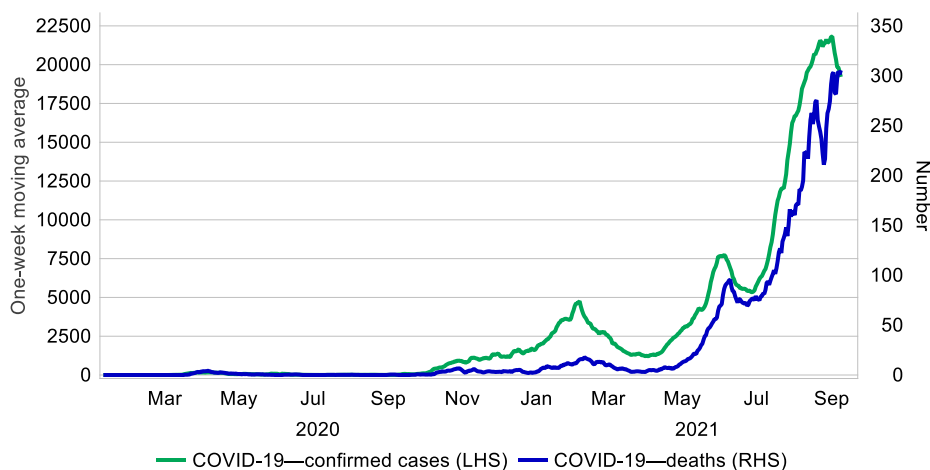
- **Rates**—We maintain the view that Malaysian government bonds will outperform their peers because we believe the market pricing of a 25bps hike in mid-2022 is too aggressive.
- **Currencies and equities**—We've turned neutral on the Malaysian ringgit (MYR) and equities from an underweight stance, as near-term growth differentials (among their regional peers) may expand.

“In our view, an easing in social distancing restrictions could unleash a strong cyclical recovery, albeit from a low base.”

Risks to our view

- **Upside risk**—In our view, an easing in social distancing restrictions could unleash a strong cyclical recovery, albeit from a low base.
- **Downside risk**—Insufficient policy support, since the government has limited fiscal policy space to maneuver, places the onus on Bank Negara Malaysia (BNM) to actively sustain the economic recovery with looser monetary policy. If BNM acts too slowly, it could delay the point at which the economy can reach escape velocity.

Malaysia: daily COVID-19 cases



Source: World Health Organization, Macrobond, Manulife Investment Management, as of September 9, 2021. LHS refers to left-hand side. RHS refers to right-hand side.

³ [“Malaysia gets a new prime minister—the country’s third in 3 years,”](#) cnbc.com, August 20, 2021. ⁴ [“PM Ismail unveils Malaysia’s biggest five-year development plan with \\$129b allocation,”](#) Straits Times, September 27, 2021.

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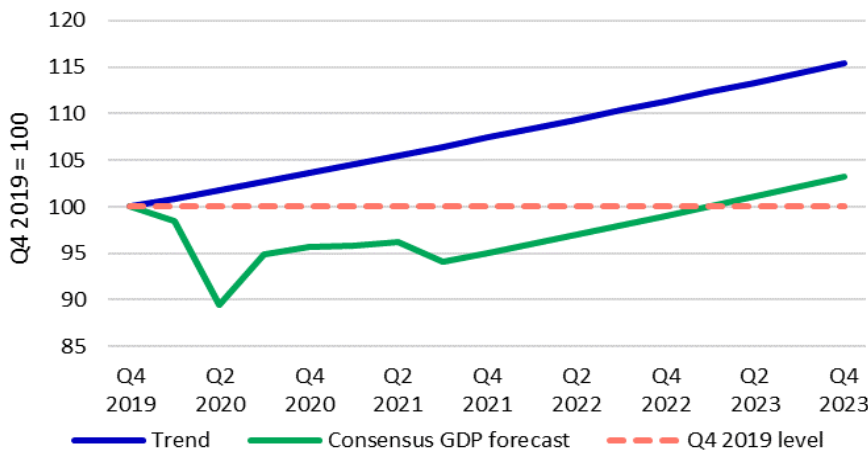
The Philippines

Big picture

The Philippines’ economic recovery continues to lag regional peers. GDP contracted by 1.3% in Q2, leaving the economy 10% below its prepandemic level and 17% below trend, by far the largest gap in the region.¹ Meanwhile, the daily COVID-19 case count is still hitting record highs, rising above 26,000 in early September.² Yet the flexibility of Bangko Sentral ng Pilipinas (BSP) to address the country’s worsening economic outlook may be constrained by sticky elevated inflation, which jumped from 4.0% in July to 4.9% in August, its highest since 2018.² But given the BSP governor’s recent rhetoric, which demonstrated “a desire to support the economy “for as long as necessary,”³ we think it prudent for the central bank to ease monetary policy further. Since real interest rates are already deep in negative territory, BSP may need to get creative with alternative modes of easing; for instance, injecting more liquidity into the financial system instead of an outright cut to the benchmark policy rate.

“Since real interest rates are already deep in negative territory, BSP may need to get creative with alternative modes of easing; for instance, injecting more liquidity into the financial system instead of an outright cut to the benchmark policy rate.”

Philippines consensus GDP forecast vs. pre-COVID-19 trend



Source: Bloomberg, Manulife Investment Management, as of September 10, 2021. Indexed to 100, using Q4 2019 as the baseline.

1 Bloomberg, as of September 10, 2021. 2 Our World in Data, as of September 24, 2021. 3 Bangko Sentral ng Pilipinas, August 11, 2021.

What we're watching

- **COVID-19 case counts**—The high number of daily infections is holding back the economic recovery.
- **Rising funding costs**—Should global real yields rise sharply and lead to tighter global liquidity, the Philippines may be subject to greater financial market instability since its external metrics (such as external debt), which are dependent on foreign financing, are weaker now relative to both the 2011 global reflation episode and 2013's taper tantrum.

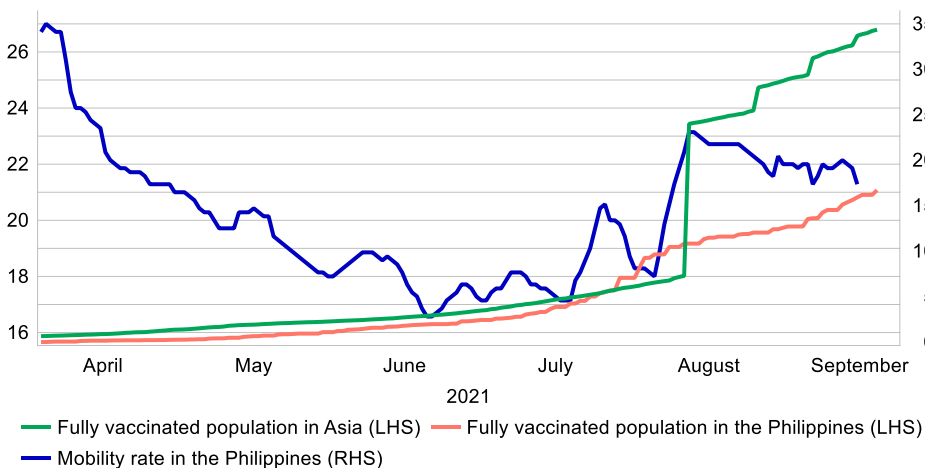
Key market views

Currencies and equities—We believe the Philippine peso and the country's equity market will underperform. Insufficient policy support to date means it will likely take much longer for the economy to recover lost output, implying it's likely to remain a regional laggard. In our view, recent equity outperformance based on an expected easing in mobility restrictions looks stretched. It's also worth noting that foreign portfolio flows have remained subdued since late last year.¹

Risks to our view

- **Upside risk**—Coordinated fiscal and monetary easing—To date, fiscal support has been limited, with the BSP having to do the bulk of the heavy lifting to support the recovery. In our view, coordinated fiscal and monetary easing is required to spur a more forceful economic recovery.
- **Downside risk**—Vaccine rollouts remain slow and mobility remains low,⁴ with both factors weighing on household consumption, the economy's predominant growth engine. Mobility data suggests economic activity is only beginning to resume gradually.

Philippines: fully vaccinated population lags the region (%)



Source: Our World in Data, Google's COVID-19 Community Mobility Report, Manulife Investment Management, as of September 10, 2021. LHS refers to left-hand side. RHS refers to right-hand side.

¹ Bloomberg, as of September 10, 2021. ⁴ Google's COVID-19 Community Mobility Report, as of September 10, 2021.

“Should global real yields rise sharply and lead to tighter global liquidity, the Philippines may be subject to greater financial market instability since its external metrics (such as external debt), which are dependent on foreign financing, are weaker now relative to both the 2011 global reflation episode and 2013’s taper tantrum.”

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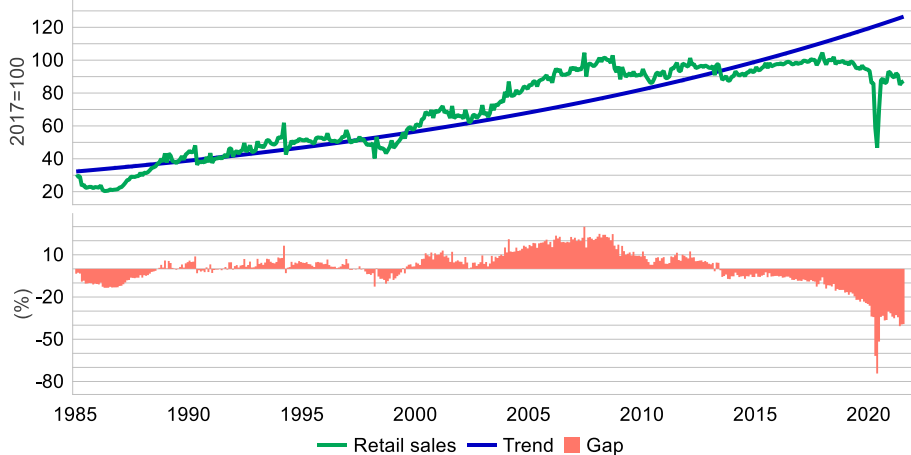
Singapore

Big picture

In June, the government shifted its stance from zero-COVID to one of living with COVID¹ as the new normal, framing it as part of a reopening strategy geared toward treating the virus as endemic. With one of the fastest vaccination rates in the world, more than 80% of the country’s population has been fully vaccinated,² paving the way for easing of social restrictions and some border controls in August. Yet one month later, Singapore found itself dealing with a new COVID-19 wave, with daily case counts at a record high² and the reimposition of mobility curbs. Singapore’s Ministry of Health warned that new daily COVID-19 cases could reach 2,000 in October.³ Data shows that Singaporeans are staying home 15% more relative to the pre-pandemic level, while mobility around workplaces and retail and recreational areas is roughly 15% below pre-COVID-19 levels.⁴

“Data shows that Singaporeans are staying home 15% more relative to the pre-pandemic level, while mobility around workplaces and retail and recreational areas is roughly 15% below pre-COVID-19 levels.”

Singapore retail sales value



Source: Singstat, Macrobond, Manulife Investment Management, as of September 12, 2021.

1 “Living normally, with COVID-19: Taskforce ministers on how S’pore is drawing road map for new normal,” straitstimes.com.sg, June 24, 2021. 2 Our World in Data, as of September 24, 2021. 3 “Sharp spike in Singapore’s COVID-19 cases worrying, next 2 to 4 weeks will be crucial: Gan Kim Yong,” channelnewsasia.com.sg, September 10, 2021. 4 Google’s COVID-19 Community Mobility Report, as of September 12, 2021.

What we're watching

- **A slowing manufacturing sector**—The prolonged nature of COVID-19-related disruptions has weighed on private consumption, but foreign demand for Singapore's exports has provided a strong offset throughout the past two years. Slowing manufacturing, therefore, removes a key pillar of growth.
- **COVID-19 trends**—Singapore's experience may slow other economies' shift to a living with COVID strategy, having seen how a new variant quickly necessitated a rethink of the approach.

Key market views

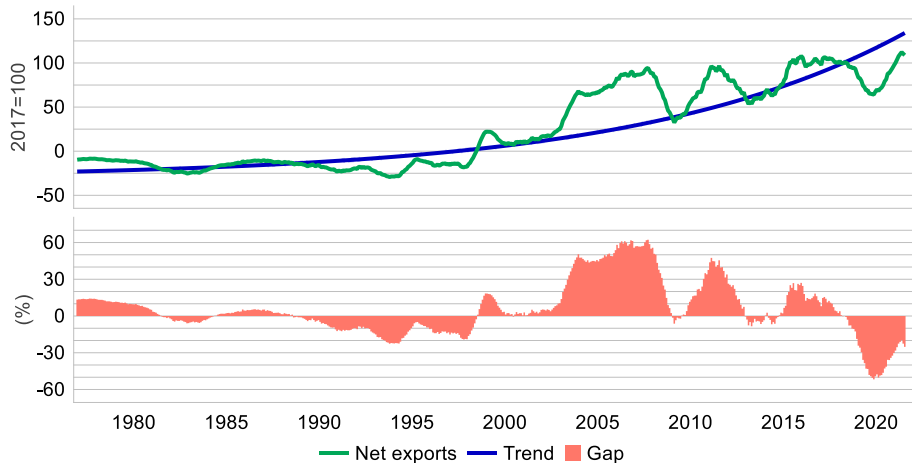
- **Equities**—We have a neutral view on Singapore equities. Our peak macro thesis suggests the cyclicality of equities should be a headwind to the stock market; however, we believe that the prevalence of high-quality banks in the Straits Times Index will offset any downward pressure that's expected to emerge.
- **Currencies**—Given uncertainties in the near-term growth outlook, inflation is likely to ease into year end, and the nominal effective exchange rate is likely to remain above the Monetary Authority of Singapore's (MAS's) midpoint target, we expect the MAS to delay returning its policy band for the Singapore dollar to an appreciation path in October.

“Our peak macro thesis suggests the cyclicality of equities should be a headwind to the stock market; however, we believe that the prevalence of high-quality banks in the Straits Times Index will offset any downward pressure that's expected to emerge.”

Risks to our view

- **Upside risk**—Should the latest COVID-19 wave moderate faster than expected, it should cause less disruption relative to the earlier waves of outbreaks.
- **Downside risk**—The sharp rise in COVID-19 infection and the government's cautious approach to reopening could weigh on the recovery.

Singapore: net exports



Source: Singstat, Macrobond, Manulife Investment Management, as of September 12, 2021.

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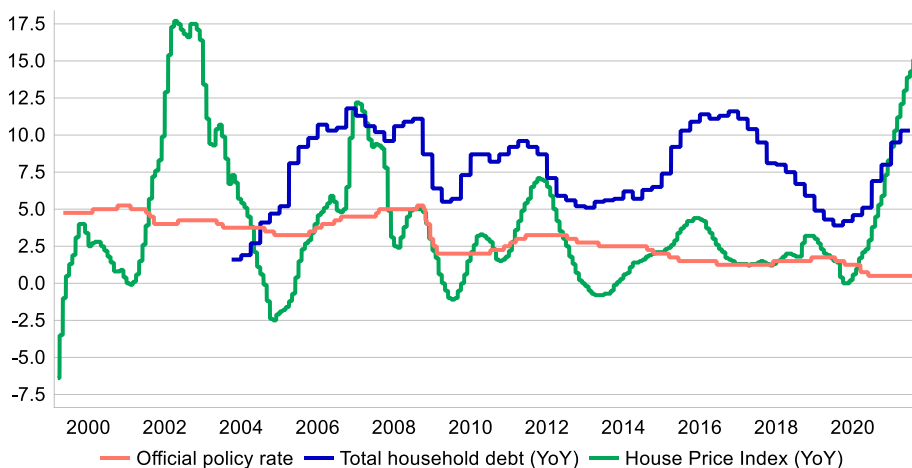
South Korea

Big picture

The biggest development in Q3 was the Bank of Korea's (BoK's) decision to raise its benchmark repo rate by 25bps, to 0.75%,¹ against consensus expectation for the bank to leave the policy rate unchanged. The BoK is the first central bank in Asia to tighten monetary policy during the pandemic, likely motivated by a desire to rein in financial imbalances. We hadn't expected the BoK to tighten so soon and thought it would use macroprudential policy first; however, with annual household debt growth rising above 10.0% and annual house price inflation accelerating at the fastest pace since 2002,² the BoK saw the need for more assertive action. South Korea's planned budget for 2022 implies that the government's fiscal policy will become the main source of support for the economy as the BoK pares monetary stimulus.

“The BoK is the first central bank in Asia to tighten monetary policy during the pandemic, likely motivated by a desire to rein in financial imbalances.”

South Korea: household debt and house price inflation (%)



Source: Bank of Korea, Macrobond, Manulife Investment Management, as of September 9, 2021. YoY refers to year over year.

¹ [“S. Korea’s vaccination drive picks up speed, little slow down in new infections,”](#) reuters.com, June 8, 2021. ² Bloomberg, as of September 9, 2021.

What we're watching

- **Inflation**—Consumer price inflation remained above the BoK's 2.0% target in August. The central bank expects it to ease in early 2022 but, in our view, persistent above-target inflation could tip the BoK into another rate hike sooner.
- **Fiscal/political**—A key uncertainty is the direction of the economic policy of the next administration, with President Moon Jae-in leaving office next May. Although a more conservative government could rein in spending plans, another win from the ruling party could mean a continued expansionary stance.

Key market views

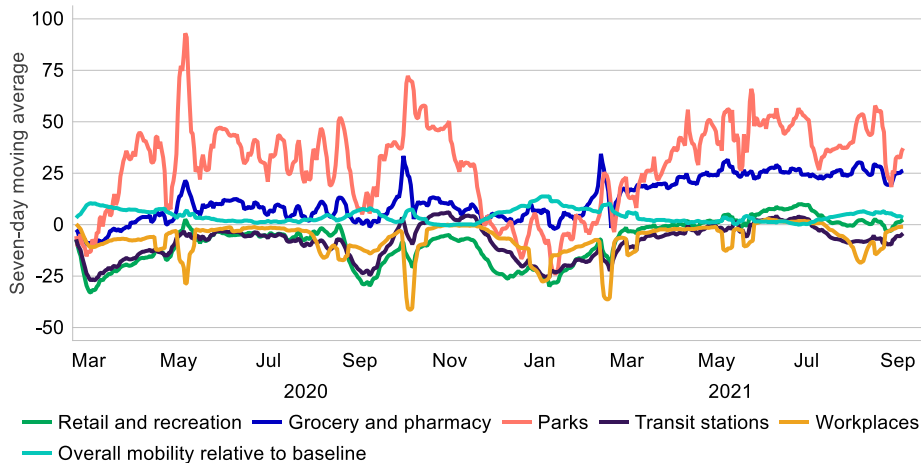
Rates and equities—South Korean government bond yields have eased, reflecting initial overpricing of the extent of the BoK's rate hikes. South Korean equities have underperformed their Asian peers so far in Q3 as a result of the surprise rate hike,² but we expect this to be a short-lived phenomenon since positioning is now better balanced and COVID-19 is relatively well contained. The market also plays a strategic role in global supply chains and, all things considered, a strong earnings recovery seems likely in the coming year.

“Despite the recent wave of COVID-19 outbreak, mobility levels in South Korea are among the highest within the region. This is likely to fuel a stronger-than-expected economic backdrop.”

Risks to our view

- **Upside risk**—Despite the recent wave of COVID-19 outbreak, mobility levels in South Korea are among the highest within the region. This is likely to fuel a stronger-than-expected economic backdrop.
- **Downside risk**—The global supply shortage may produce increasing headwinds to the country's export sector as inventories are depleted.

Mobility level in South Korea



Source: Google's COVID-19 Community Mobility Report, Macrobond, Manulife Investment Management, as of September 9, 2021. The baseline is the median value for the corresponding day of the week during the five-week period between January 3, 2020, and February 6, 2020.

² Bloomberg, as of September 9, 2021.

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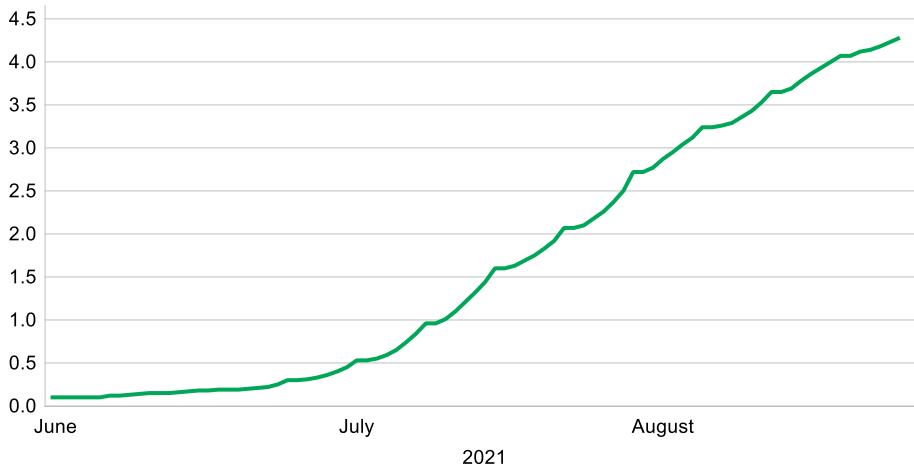
Taiwan

Big picture

Taiwan’s economy contracted slightly in Q2, by 1.07%, from the previous quarter.¹ Despite experiencing a major COVID-19 outbreak, strong exports and positive investment flows helped to mitigate the sharp decline in private consumption. While the pace of COVID-19 vaccinations has started to pick up again, coverage remains relatively low, exposing the economy to the possibility of lockdowns in the event of successive COVID-19 variants. Both Taiwan’s central bank and government have been actively promoting economic recovery: The Central Bank of the Republic of China (CBC) has expanded and extended its loan guarantee program to small and medium-sized enterprises,² and the government enlarged its fiscal support.³

“Despite experiencing a major COVID-19 outbreak, strong exports and positive investment flows helped to mitigate the sharp decline in private consumption.”

Taiwan: population fully vaccinated against COVID-19 (%)



Source: Our World in Data, Macrobond, Manulife Investment Management, as of September 10, 2021.

¹ Bloomberg, as of September 10, 2021. ² “[Central bank raises cap on loans for small businesses](#),” taipeitimes.com, June 24, 2021. ³ “[Taiwan to hand out more stimulus coupons to boost consumer spending by \\$7.2 bln](#),” reuters.com, September 9, 2021.

What we're watching

- **Global demand**—Given the importance of foreign demand in driving GDP growth, the leveling off in new export orders in recent months needs monitoring.
- **Inflation**—Rarely a concern in Taiwan, but July headline CPI inflation rose to 2.36% YoY, toward the top of the range for over a decade.¹

Key market views

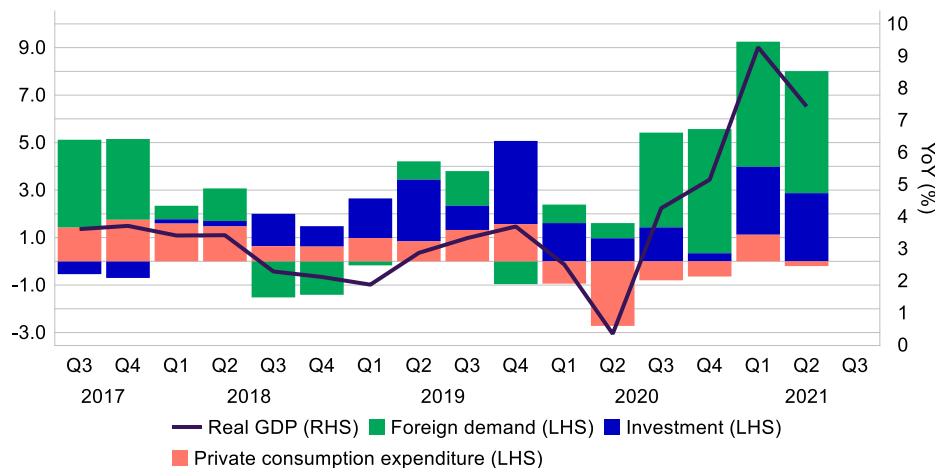
- **Equities**—Strong balance sheets, high dividend yields, and a near-monopolistic hold on the semiconductor sector are pillars of support for the stock market; however, valuations may be considered expensive.
- **Currencies**—Although there are signs that the USD is rebounding and the Chinese yuan is topping out¹ (which typically suggests that the Taiwanese dollar would weaken vs. the USD), there are mitigating factors that may contain the downward pressure. These factors include a considerable tightening in U.S. financial conditions (i.e., a limited misalignment in real effective exchange rate) and/or an improvement in Taiwan's external position.

“In our view, continued global chip supply bottlenecks should benefit Taiwan disproportionately than more-diversified goods exporters.”

Risks to our view

- **Upside risk**—In our view, continued global chip supply bottlenecks should benefit Taiwan disproportionately than more-diversified goods exporters.
- **Downside risk**—Taiwan's reliance on foreign demand continues to be a concern. Self-sustaining growth requires strong private domestic demand, and Taiwan's consumption growth remains a drag on GDP growth.

Contributions to real GDP (%)



Source: Macrobond, Manulife Investment Management, as of September 10, 2021. LHS refers to left-hand side. RHS refers to right-hand side. YoY refers to year over year.

¹ Bloomberg, as of September 10, 2021.

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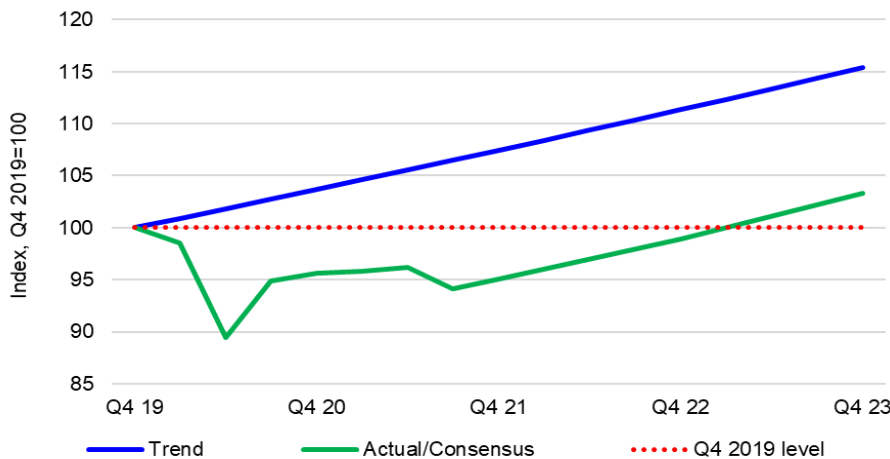
Thailand

Big picture

A prolonged COVID-19 wave between May and August—and high daily case counts—has weighed heavily on the Thai economy. Phuket was the first Thai province to reopen: The authorities waived a mandatory quarantine for vaccinated foreign visitors in July after more than 70% of local residents had been inoculated.¹ However, results have been disappointing: Only 26,695 visitors flew in during the first two months of the program.² In June, the Bank of Thailand (BoT) forecast 700,000 foreign visitors for the year—a target that was revised to 150,000 just two months later.³ In our view, the BoT is close to cutting its benchmark policy rate to an all-time low of 0.25% amid downside risks to GDP growth and core CPI being on the brink of disinflation—registering just 0.07% in YoY terms. Current consensus expectations have pushed out the timing of the economic recovery to 2022/2023.⁴ Even then, Thailand’s GDP is expected to remain over 12% less than its prepandemic trend.

“In our view, the BoT is close to cutting its benchmark policy rate to an all-time low of 0.25% amid downside risks to GDP growth and core CPI being on the brink of disinflation—registering just 0.07% in YoY terms.”

Thailand: consensus GDP forecasts vs. pre-COVID-19 trend (%)



Source: Bloomberg, Manulife Investment Management, as of September 12, 2021.

1 “The party island of Phuket opens to those willing to follow many of its rules,” cnbc.com, July 1, 2021. 2 Tourism Authority of Thailand, September 4, 2021. 3 Bank of Thailand, August 4, 2021. 4 Bureau of Trade and Economic Indices, Thailand, September 2021.

What we're watching

- **COVID-19 trends**—Daily deaths and case counts appear to have peaked, but absolute numbers remain elevated. Vaccinations have also ramped up, but the absolute rate remains low. In our view, improvements on these two fronts are a precondition to lifting private consumption and tourism.
- **Fed taper**—Since Thailand's current account surplus has eroded,⁵ rising U.S. interest rates could herald further depreciation pressure for the Thai baht (THB).

Key market views

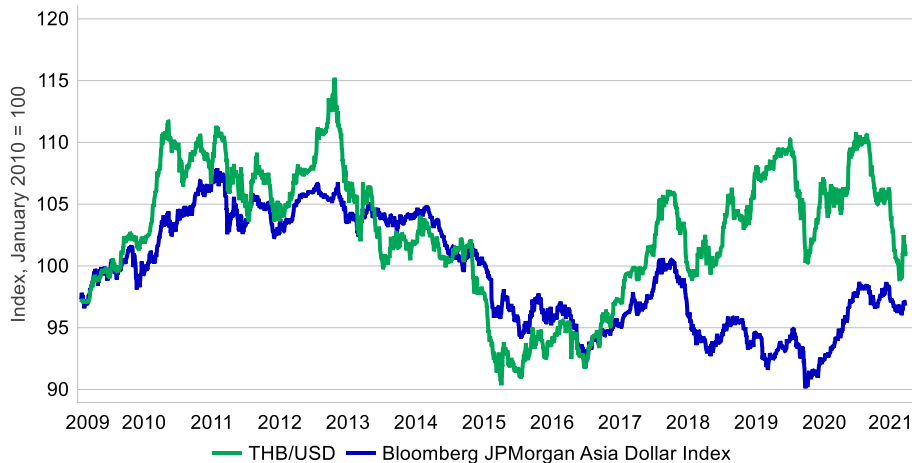
- **Equities**—We believe corporate earnings could be revised upward once the authorities are able to contain the COVID-19 outbreak. From a historical perspective, stocks appear relatively inexpensive and remain underowned by foreign investors.
- **Currencies**—The THB has been one of the worst-performing Asian currencies in the past quarter,⁵ but its valuation in relation to its Asian peers still looks disconnected relative to the economy's GDP and monetary policy prospects. We expect the THB to continue to underperform.

“The THB has been one of the worst-performing Asian currencies in the past quarter, but its valuation in relation to its Asian peers still looks disconnected relative to the economy’s GDP and monetary policy prospects.”

Risks to our view

- **Upside risk**—With public debt below 60% of GDP (a self-imposed ceiling), proactive fiscal policy would help to cushion the economy.
- **Downside risk**—Prolonged pandemic disruption increases the risk that Thailand experiences a second year of economic contraction, which hasn't occurred since the Asian financial crisis.

THB appears overvalued relative to other Asian currencies



Source: Bloomberg, Manulife Investment Management, as of September 12, 2021.

⁵ Bloomberg, as of September 12, 2021.

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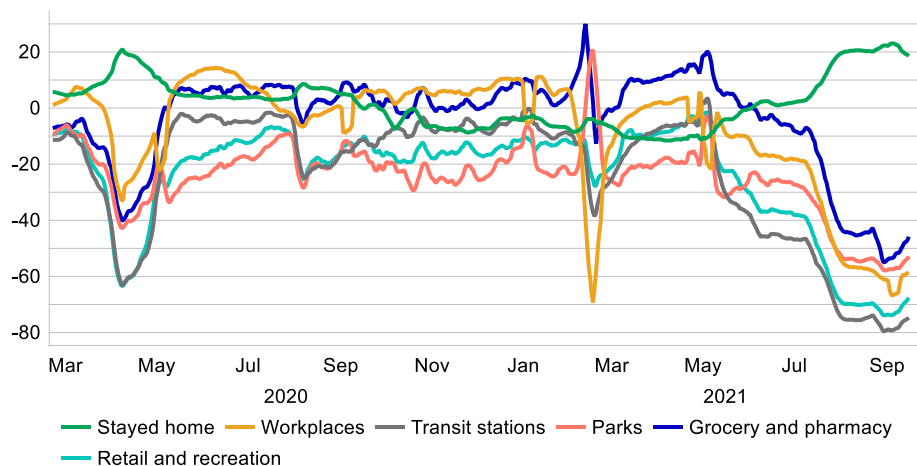
Vietnam

Big picture

The pandemic has taken a heavy toll on Vietnam’s economy. Despite earlier success in containing infections, Vietnam is experiencing a record surge in daily infections of around 17,000 as of late August.¹ Hard lockdowns have been in place since at least June, and data shows that the mobility level in Vietnam is the lowest in the region—even lower than that seen early in the pandemic.² Vietnam’s COVID-19 vaccination rate has also lagged regional peers, with less than 8% of the population having been fully inoculated.¹ Having increased vaccine procurement, the government has plans to significantly speed up the pace of delivery, targeting 70% of the population by the end of March 2022,³ which could put the country’s economy on the path to recovery.

“Having increased vaccine procurement, the government has plans to significantly speed up the pace of delivery, targeting 70% of the population by the end of March 2022, which could put the country’s economy on the path to recovery.”

Mobility levels in Vietnam (%)



Source: Our World in Data, Google’s COVID-19 Community Mobility Report, Manulife Investment Management, as of September 12, 2021. The baseline is the median value for the corresponding day of the week during the five-week period between January 3, 2020, and February 6, 2020.

1 Our World in Data, as of September 24, 2021. 2 Google’s COVID-19 Community Mobility Report, as of September 12, 2021. 3 Reuters, July 10, 2021.

What we're watching

- **COVID-19 trends**—Daily deaths and case counts appear to have peaked in earnest, but absolute numbers remain elevated. An improvement in the vaccination rate will be key to avoiding rolling and prolonged economic disruptions.
- **Fed communication**—As we enter a period of uncertainty regarding the timing of the Fed's plan to scale back its bond purchasing program, we could see potential volatility in the USD and U.S. interest rates, which would affect Vietnam's economic outlook.

Key market views

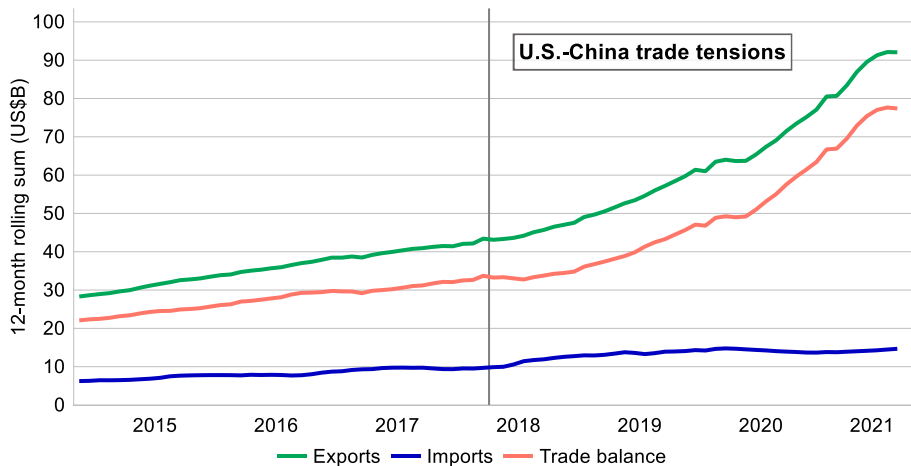
- **Equities**—We think Vietnamese equities will be supported by a relatively stronger defensive growth tilt.
- **Currencies**—We expect the Vietnamese dong to remain on the strong side of the +/-3% of its current trading range on the back of the country's recent agreement with the United States regarding its currency practices.

“As we enter a period of uncertainty regarding the timing of the Fed’s plan to scale back its bond purchasing program, we could see potential volatility in the USD and U.S. interest rates, which would affect Vietnam’s economic outlook.”

Risks to our view

- **Upside risk**—The United States and Vietnam came to a truce in late July over Vietnam's foreign exchange policy. Vietnam agreed to improve exchange rate flexibility over time and the United States withdrew threats to impose tariffs on Vietnamese goods.⁴ This is positive for Vietnam's export growth since the United States is its biggest export market.⁵ If exports to the United States declined to the prevailing level at the start of the U.S.-China trade war, it would have knocked 7.5% off Vietnam's GDP.⁶
- **Downside risk**—Slowing momentum can be seen in Vietnam's two largest export destinations: China and the United States. Exports to both markets accounted for ~45% of Vietnam's GDP in 2020.⁷

Vietnam: trade with the United States



Source: Vietnamese General Statistics Office, General Department of Customs, Macrobond, Manulife Investment Management, as of September 12, 2021.

⁴ Office of the U.S. Trade Representative, July 23, 2021. ⁵ Bloomberg, as of September 12, 2021. ⁶ Manulife Investment Management, as of September 12, 2021. ⁷ Vietnamese General Statistics Office, as of September 12, 2021.

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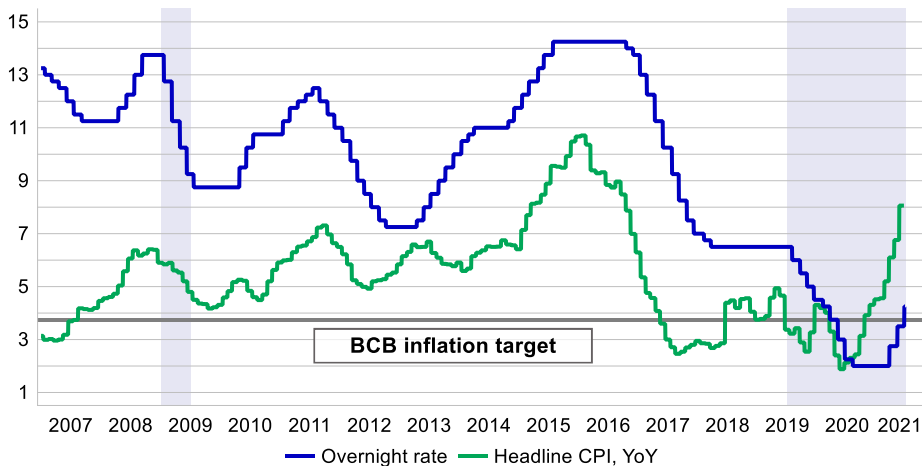
Brazil

Big picture

The worst of Brazil’s COVID-19-related economic downturn is likely behind us, but sentiment continues to be plagued by country-specific risks and a complicated economic backdrop. The successful vaccine rollout makes Brazil a leader of inoculation rates in both Latin America and comparable emerging-market regions¹—we view this as a tailwind to growth moving forward. While COVID-19 concerns have subsided, stagflationary tendencies have risen, with downside surprises to growth and upside surprises to inflation. Given excess slack in the economy, we expect growth to continue to recover as Brazil moves through its reopening, but the expiration of coronavouchers² along with stubbornly high inflation will likely act as a headwind to consumer demand.

Inflation continues to clock in at the high end of single digits due to a rise in food and electricity costs.³ The country—which relies heavily on hydroelectric power for electricity—is facing one of the worst droughts in years, and regulators hiked tariffs by 52% in the hope of curbing demand.

Hawkish BCB with above-target CPI (%)



Source: Macrobond, Manulife Investment Management, as of September 15, 2021. YoY refers to year over year. CPI refers to Consumer Price Index. The gray areas represent recessions.

1 Our World in Data, as of September 15, 2021. 2 “COVID in Brazil: Hunger worsens in city slums,” bbc.com, April 18, 2021. 3 Bloomberg, as of September 15, 2021.

“While COVID-19 concerns have subsided, stagflationary tendencies have risen, with downside surprises to growth and upside surprises to inflation.”

What we're watching

- **Inflation**—Inflation remains well above the central bank's target of 3.75% and will likely continue to be a driver of further rate hikes at upcoming BCB meetings this year (October 27 and December 8).³ Market expectation is for the Selic rate to hit the 7.95% level by year end³ and we believe rate hikes that are in line or greater than the consensus forecast will be favorable for the Brazilian real (BRL).
- **Foreign investment flows**—As of this writing, the BRL is trading at historically low levels relative to the USD.³ We believe international demand for Brazilian assets will ultimately continue to be a major driver of BRL strength.

Key market views

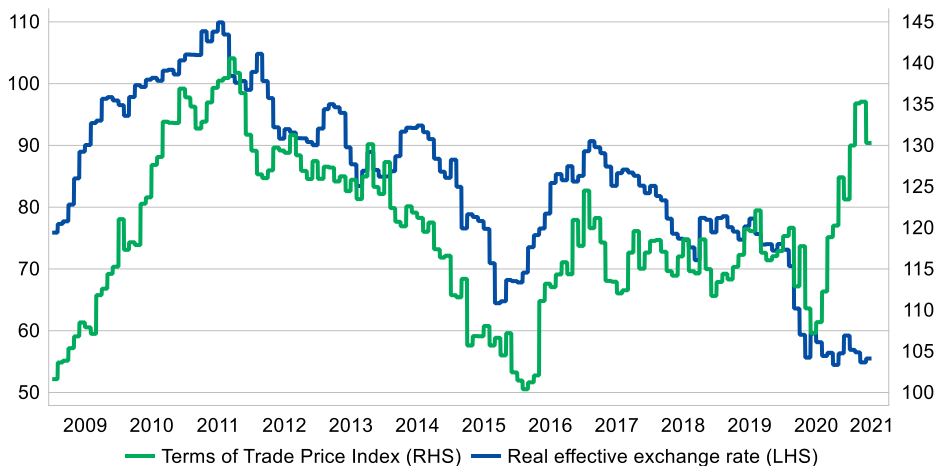
- **Currencies**—Intensifying political tension in the country is threatening a rally in the BRL (against the USD), which has pushing toward the mid- to upper five area—levels last observed in Q4 2020 and Q1 2021.
- **Equities**—In our view, valuations of Brazilian equities are at historically attractive levels,³ and our analysis shows that the asset class's fundamentals are, broadly speaking, stronger than they were before the pandemic. We believe the MSCI Brazil Index will benefit from the reopening given the cyclical exposure of the index's sectoral breakdown: Materials and energy currently make up a third of the index, while financials account for about a quarter.³ That said, expected volatility on the currency front could deter foreign investors from investing in Brazilian assets.

“In our view, valuations of Brazilian equities are at historically attractive levels, and our analysis shows that the asset class's fundamentals are, broadly speaking, stronger than they were before the pandemic.”

Risks to our view

- **COVID-19**—The pandemic crippled Brazil's economy as the country's death rate ranked among the worst in the world, a situation made worse by the emergence of the Gamma variant. While things appear to be improving, the risk of resurgence remains. Continued vaccine rollout will be critical for Brazil to contain the outbreak.
- **Geopolitics**—Political risks continue to weigh on Brazil, driven by concerns about government transparency and fiscal lassitude. Data suggests the government is at risk of exceeding its 2022 budget and, as such, fears regarding the sustainability of existing social programs and other transfer payments are valid. In addition, uncertainty related to the 2022 presidential election remains a concern for international investors.

Correlations between the BRL and Brazil's terms of trade are weakening



Source: Macrobond, Manulife Investment Management, as of September 15, 2021. LHS refers to left-hand side. RHS refers to right-hand side.

³ Bloomberg, as of September 15, 2021.

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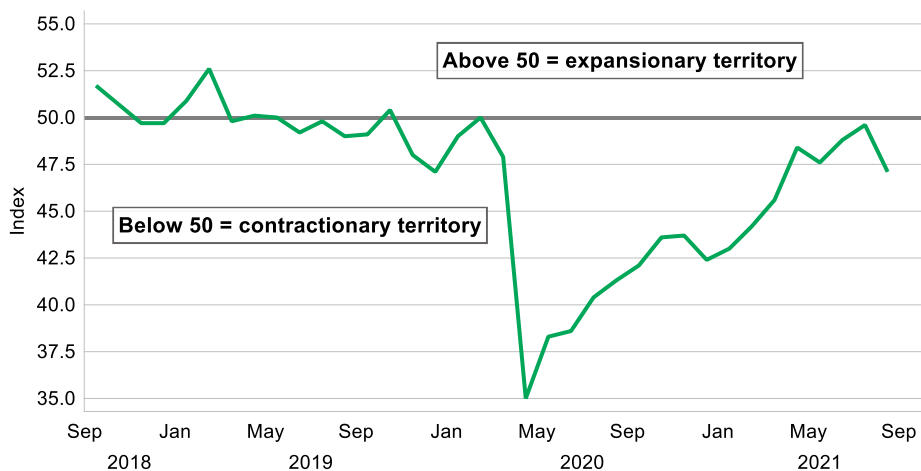
Mexico

Big picture

Mexico’s economic outlook is gradually improving as the nation continues to emerge from the economic shock brought about by COVID-19. Higher oil prices are delivering an improvement to the country’s terms of trade¹; however, high-frequency growth indicators hint at ongoing struggles within the industrials sector as the manufacturing Purchasing Managers’ Index (PMI) remains in contractionary territory (i.e., below 50).¹ That said, Mexico’s fiscal situation is improving, and the 2022 budget proposal includes increased transfers to regional and local governments.² Markets have also responded positively to President Andrés Manuel López Obrador’s proposal to use a portion of forthcoming funds from the International Monetary Fund to reduce debt burden of state oil company, Pemex.³

Although inflation had been a concern through much of Q2 and Q3, headline CPI appears to be rolling over, and policymakers at Banxico are reassessing their monetary policy outlook in light of this development. The Mexican peso (MXN) remains well supported against the greenback, as USD/MXN trades below the psychologically important 20.00 level.¹

Mexico: manufacturing PMI



Source: Macrobond, Manulife Investment Management, as of September 15, 2021.

¹ Bloomberg, as of September 15, 2021. ² [“Mexico’s 2022 budget to focus on financial stability, regional development,”](#) reuters.com, September 8, 2021. ³ [“Mexican president hints at eyeing IMF funds to pay Pemex debt,”](#) reuters.com, September 6, 2021.

“Higher oil prices are delivering an improvement to the country’s terms of trade; however, high-frequency growth indicators hint at ongoing struggles within the industrials sector as the manufacturing Purchasing Managers’ Index remains in contractionary territory (i.e., below 50).”

🔍 What we're watching

- **Global financial conditions**—From a macro perspective, we think Mexico has fared relatively well so far in 2021, considering global central banks such as the Fed have already begun taper talk and the ECB announced plans to recalibrate its asset purchases (to the markets' surprise). We'll continue to closely watch for signs of a turn, given that Mexico typically bears the early brunt of tighter global conditions due to the relatively large foreign ownership of government debt.¹
- **Banxico**—Mexico's central bank delivered a pair of 25bps interest-rate hikes so far in 2021 (Q2 and Q3).¹ The first hike was relatively unanticipated and appeared to be a swift response to higher-than-expected inflation prints; however, policymakers appear to be softening their expectations for further tightening.

⊞ Key market views

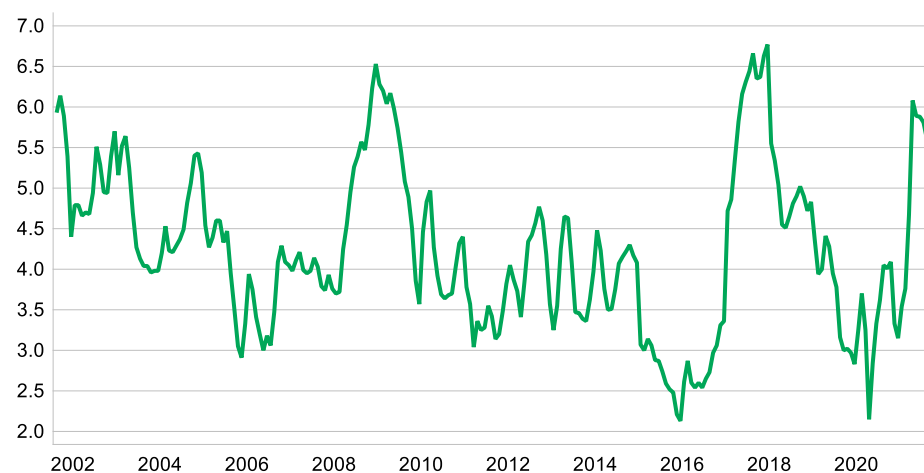
Currencies—We continue to highlight the psychologically important 20.00 level in the USD/MXN pair and view it as a critical barometer of sentiment. From a technical perspective, USD/MXN has delivered a sequence of lower highs year to date—against a flat support level—setting itself up for a meaningful push lower and a more fulsome retracement of the early 2020 COVID-19-related rally.

“Oil prices remain critically important to Mexico; however, we believe the associated downside risk is diminished by the country’s extensive hedging program.”

Risks to our view

- **The energy market**—Oil prices remain critically important to Mexico; however, we believe the associated downside risk is diminished by the country’s extensive hedging program.⁴ A renewed rally in oil prices would be positive for Mexico, delivering an improvement in the country’s terms of trade that should, as per usual, be reflected in a stronger currency.
- **Domestic manufacturing**—It’s an area that remains challenged, despite the economic reopening in the United States. We see potential upside risk to Mexico’s manufacturing sector as the country experiences a more fulsome emergence from the pandemic.

Mexico: Consumer Price Index, YoY (%)



Source: Bloomberg, Macrobond, Manulife Investment Management, as of June 25, 2021. YoY refers to year over year.

¹ Bloomberg, as of September 15, 2021.

⁴ [“Mexico forecasts \\$60 per barrel for 2022 crude oil exports,”](#) reuters.com, August 27, 2021.

A widespread health crisis such as a global pandemic could cause substantial market volatility, exchange-trading suspensions and closures, and affect portfolio performance. For example, the novel coronavirus disease (COVID-19) has resulted in significant disruptions to global business activity. The impact of a health crisis and other epidemics and pandemics that may arise in the future could affect the global economy in ways that cannot necessarily be foreseen at the present time. A health crisis may exacerbate other preexisting political, social, and economic risks. Any such impact could adversely affect the portfolio's performance, resulting in losses to your investment.

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