

THE BIG PICTURE OF GLOBAL ECONOMICS



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Upgrades Everywhere

- Economists raise global GDP forecasts after a strong start to the year
- Many economists add one to two percentage points to their GDP growth forecasts
- Fed Chairman Powell speaks this week - will he deflect from the easy money line?
- Stay long equities and be very careful with bond duration

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Global GDP: Upgrades everywhere

The global economy has far more momentum than previously thought. In the past week, economists have been moving their **GDP forecasts up by one to two percentage points**.

Confirmation of more robust trends is evident from economic data releases that have comfortably beating market expectations. US retail sales and industrial confidence data were all on the very strong side.

Overweight equities, short duration

We retain our overweight of equities with a bias to Asia. In fixed income short duration is key. We expect judicious choices of strategic bond funds to add value instead of straight government bond exposure.

Global economic growth looks set to materially surprise to the upside in 2021.

In recent weeks economic data releases worldwide show that the second lockdown has had a much less material impact on the global economy than the dark days of last March-June. Several economists marked their growth forecasts higher by as much as 1.5% for the year in the past week. Global growth of 6.5% this year and 4.5% for 2022 is rapidly becoming a consensus.

The US is the surprise, primarily driven by very supportive fiscal and monetary policy. Coming up soon will be another round of fiscal support to the tune of \$1.9 trillion. The open question in the market is just how long is the Fed prepared to maintain its view of no interest rate increases until the back end of 2023. The Fed clearly didn't make that commitment with such evident vibrancy in growth and inflation risk building.

We expect the Fed to stay patient.

Later this week, Fed Chair Powell will be giving testimony. It will be an important opportunity to signal how the Fed might respond to the brightening outlook. Specifically, the market will be looking for insights into the Fed's view of the risk to the economy of rising long-dated bond yields. We expect Powell's message to be one of forbearance: the Fed likely views the inflation pressure as transitory. In any case, the Fed is probably more comfortable with some reset of market expectations for inflation expectations in the market around its own 2% target.

The lagged improvement of the US labour market likely gives the US policy makers the opportunity to continue to talk a dovish story.

November and December employment data was weaker-than-expected results, with November's number being revised downward and December's a disappointing loss of 227K jobs. January saw a tepid recovery to 49K, which was only half the forecast number.

By contrast to the weak employment numbers, data from the manufacturing sector is highly encouraging. The US manufacturing PMI went above 60 in December, which is the highest since 2003.

The aggregate stronger data in the US has not been lost on economists. Economists have typically added to their previous forecasts of 4% growth and are now 6% and higher.

Global growth is also rebounding at a faster pace than anticipated. The policy response in Europe has not been nearly as aggressive as the US, but some tailwinds are developing nonetheless. Slowly-receding COVID restrictions, coupled with a growing momentum of vaccine roll-outs (especially in the UK), will support consumer spending. Industrial output in Western

Europe has been less affected in round two, mainly due to more targeted movement restrictions. While this has made its mark on the services sector – the pre-pandemic EU services PMI was running at 50-52, but still lags at 44 now – the manufacturing PMI has spiked to a very healthy 57.7 in February.

A sharp rebound expected in Europe

Slowing infections in Europe. A key factor, possibly underestimated by the market at the moment, is that infections in Europe are already running much lower today than at the beginning of January. For example, Germany reported a 7-day moving average rate of 7,359 cases last week compared to 25,000 in the last week of 2020. In two other major economies, Spain and the UK, a similar pattern is established.

Even absent further policy support, this sets up Europe for a spring bounce in growth. To date, the vaccine roll-out in Europe has been a disappointment, but any acceleration in the program, coupled with the strength in manufacturing already seen, will push GDP readings higher than expected initially. So while Q1 will still reflect the worst of the second wave's effect and its restrictions – look for a number around -1%, the second and third quarter number could handily exceed 10% on an annualised basis. The ECB is very likely to tolerate this surge in growth and the temporary jump in inflation already seen.

Putting it all in the mix: The combined effect of the factors mentioned could add at least 2% to global GDP for 2021. In the near term, the risk of a sudden pullback in stimulus looks remote. Governments have put too much on the line to make an about-face now. The risk of an inflation spike is growing but is still a small risk. Central banks will not be immediately worried about inflation and have also spent considerable effort to revive it. They will not look to crush it before it has normalised.

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