Economic Update
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International Scene

Global growth revised up as Biden outlines giant infrastructure proposal

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Highlights

- **The IMF revised up its forecast for global growth in 2021 to 6% with vaccination progress lifting prospects especially in developed markets. Price pressures are emerging however, and if sustained could jeopardize the recovery.**
- **The US recovery should lead the way and was given a further boost from President Biden's $2 trillion infrastructure upgrade proposal. Jobs growth exceeded 0.9 million in March and could even quicken as the reopening gathers steam.**
- **The Eurozone's economic outlook is weaker, though improving vaccination rates are starting to offer hope. The UK is pressing ahead with its reopening plan and activity in manufacturing and construction hit multi-year highs in March.**

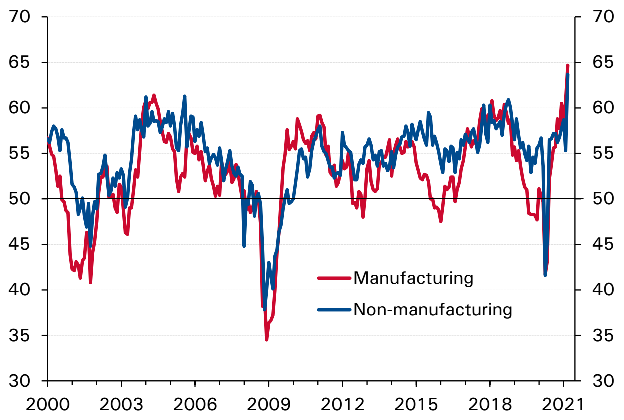
Global growth prospects for 2021 continue to be strong and are generally being revised higher fueled by a rebound from last year's steep contraction, huge policy support in the US and a vaccine rollout that is accelerating if greatly varied by country. The IMF upgraded its 2021 world growth forecast by 0.5% to 6.0% due in particular to stronger growth in advanced economies (5.1%), though growth in emerging markets will remain faster (6.7%). Despite the generally rosier picture however, the global economy is still not out of the woods, with a surge in virus cases triggering new restrictions across India for example and concerns about virus mutations persisting even in countries with high vaccination rates. Meanwhile, the risk that stronger growth combined with supply chain disruptions and higher raw material costs will push inflation up continues to warrant attention. Official inflation statistics do not yet reflect this, but pipeline price pressures are clearly emerging and if sustained could hurt businesses, rattle confidence and force central banks to unwind policy stimulus, hitting the recovery.

Biden targets more stimulus – this time on infrastructure

Already underpinned by a rapid vaccine rollout, business reopening and huge pent-up demand, US growth prospects were handed a further boost with the announcement of a proposed $2 trillion (9% of GDP) in public spending on infrastructure, including on roads and bridges, public transit, housing, broadband and subsidies for green technology. This comes on top of the $2.8 trillion in fiscal stimulus implemented over two packages since December. If implemented, the near-term impact will be much smaller than the previous ones however since the outlays will take place over 10 years and be partially offset by big hikes in corporation taxes (albeit over a 15-year period). The recovery's momentum is already clearly visible from rebounding macroeconomic data, including surging ISM survey figures for both manufacturing and services in March, and a leap in non-farm jobs by a much stronger-than-expected 916,000. (Chart 1.) With employment still 8 million (or 6%) below pre-pandemic levels, several months of similarly strong jobs figures looks likely, which should in turn underpin the return in consumer confidence and spending. Some forecasts now put GDP growth as high as 8% this year, versus -3.5% in 2020.

Chart 1: US ISM activity surveys

(index, 50=no change)



Source: Refinitiv

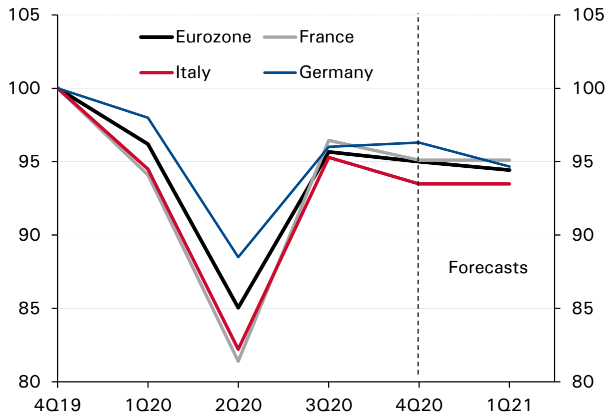
The Federal Reserve left its policy on hold in March and continued to argue that – despite growing concerns – rapid economic growth (it expects 6.5% this year) is unlikely to push up inflation very much given the remaining slack in the economy. But a sustained spell of strong economic data would put the bank under escalating pressure over coming months. While core PCE inflation stood at just 1.4% y/y in March it could spike well above the 2% target in the next few months due to year-on-year base effects. More significantly, survey data already show firms facing steep input price increases amid capacity constraints, supply chain disruptions and higher raw material costs – which could eventually translate into higher consumer prices especially as demand revives. Although the Fed has said it is willing to tolerate inflation of above 2% for a while, it may be forced to start dialing back on its aggressive easing stance by year-end.

Restrictions leave Eurozone economy under pressure

In the Eurozone, the economic outlook is much softer than in the US. Major restrictions are still in place across most large countries and potentially set to tighten over coming days with virus cases rising, hospitals under pressure and vaccine rollout lagging behind (if improving). The PMI activity data continue to hold up relatively well, rising to 53.2 in March from 48.8 in February, with strong manufacturing performance perhaps starting to benefit services, which continued to contract but at a slower pace. But with GDP likely to have fallen again in 1Q21, recent restrictions could delay the recovery proper until Q3. (Chart 2.) Reflecting the challenging outlook, a recent climb in government bond yields and its own forecast that inflation would remain well below the 2% target, the European Central Bank pledged to step up the pace of bond purchases in 2Q21 under its PEPP program by an undisclosed amount (previously €60 billion per month). However it stopped short of expanding the total limit of the €1.85 trillion program and divisions within the bank's Governing Council – both over bond buying and the timing of the recovery – may be preventing a more decisive policy response.

Chart 2: Eurozone GDP

(index, 4Q 2019=100)



Source: Refinitiv, third party forecasts

UK growth meanwhile remains on track for a speedier recovery, with 60% of all adults inoculated (with at least one dose) by early April, which combined with falling virus incidence triggered the next phase in the government's reopening plan including non-essential retail stores. Indeed, the government is under pressure to speed up the reopening, which at present will not be completed until June. Reflecting these developments, PMI activity indices for manufacturing (58.9) and construction (61.7) hit multi-year highs in March, while services also rose (56.3). Although GDP is likely to have declined in 1Q21 overall due to restrictions imposed at the start of the quarter, a strong rebound in Q2 looks inevitable, with additional momentum from the economy being one of the worst hit in Europe in 2020 (-9.9%), providing scope for a stronger rebound. Downside risks include the scale of the rise in unemployment when fiscal support policies are withdrawn later this year, a lingering impact from social distancing and travel restrictions on the services sector, post-Brexit trade tensions with the EU and a possible third wave of virus cases later this year about which the authorities are already warning.

Japanese economy still battling pandemic pressures

Japan's ruling party has signaled the possibility of an additional budget for the current fiscal year as the economy continues to battle the repercussions of the pandemic. This comes after Japan's parliament passed a ¥106.6 trillion ($963 billion) budget for the fiscal year (beginning April), which includes a ¥5 trillion fund set aside for emergency expenditures related to the pandemic. Meanwhile, exports fell 4.5% y/y in February on the back of a decline in US-bound shipments of automobiles. Retail sales were also down (-1.5% y/y) on a decline in consumer spending (-6.6% y/y) due to the extended state of emergency (ended in mid-March). Additionally, the service sector PMI extended declines in March, albeit rising from 46.3 to 48.3 (still below the 50 level mark). On a positive note, manufacturing activity gathered pace in March, with the PMI rising to 52.7 from 51.4 in February. Analysts now forecast a contraction in Japan's GDP in the first quarter (-1.2% m/m in February), which should, however, precede a gradual, export-driven recovery in the quarters that follow.

Chinese economic outlook remains robust

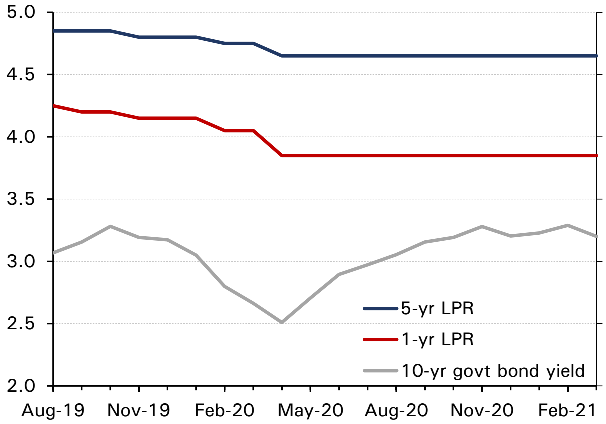
In China, a strong economic recovery is expected this year despite increasing tensions with the US and Europe. In fact, the IMF raised its forecast for Chinese growth in 2021 to 8.4%, 0.3 % points above the January forecast, while indicating that the recovery remains "somewhat unbalanced" as it is still heavily reliant on public support and investment, and private consumption has not recovered as fast as hoped. However, less than three months after reaching a deal that would give European companies better access to Chinese markets, China blacklisted members of the European Parliament after the EU joined the US and the UK in sanctions against Chinese officials over human rights issues. The dispute highlights how difficult it will be for the West to balance its economic interests with human rights concerns. On the other side, China signed a 25-year pact with Iran worth $400 billion. The deal will undoubtedly lessen the US influence in isolating Iran and provide a major outlet for Iranian oil.

The central bank left its benchmark interest rates unchanged (1-year 3.85%, 5-year 4.65%) for corporate and household loans for the eleventh straight month, and warned banks to slow their lending this year for fear of stoking asset bubbles. (Chart 3.)

Meanwhile, the official non-manufacturing PMI rose to a 4-month high of 56.3 in March from 51.4 in February. The smaller enterprise-focused Caixin manufacturing PMI however grew at the slowest rate in almost a year (50.6) on softer domestic demand. The post-Covid economic rebound therefore remains unequal.

Chart 3: Chinese interest rates

(%, end month; Loan Prime Rates and government bond yield)



Source: Refinitiv

Surging virus cases a threat to India's recovery

India's economy is on track to extend its recovery in 1Q21 (4Q FY20/21) helped by the ongoing vaccine drive, which has boosted recovery optimism and lent support to business activity. However, a recent surge in new virus cases with cases reaching a record 7-day average of 127,000 as of April 10, has led to renewed restrictions and presents a severe downside risk to the outlook. Recent PMI data points to a slight deceleration in the pace of business activity, but still pointed to a healthy pace of expansion for both services (54.6) and manufacturing (55.4) respectively in March. On the other hand, employment continued to fall, as firms continued to cut jobs amid an uncertain economic and virus outlook. The labor market weakness coupled with rising inflation (5% in February) stemming from higher input and commodity prices could adversely affect disposable income and purchasing power and thus weigh on the recovery. On the policy front, the Reserve Bank of India (RBI) kept its key policy repo rate unchanged at 4%, pledging to remain accommodative in support of the recovery. Though the room for potential monetary or fiscal policy action is tight given the relatively high inflation rate (though still within the RBI's 4-6% target) and mounting public debt.

The budget for FY21/22 details a notable rise in public spending mainly on large infrastructure projects in the health and industrial sectors, which should help support a projected GDP rebound of 12.5% for FY21/22 after an estimated 8% contraction in FY20/21 (IMF). Additional support comes from an improving global outlook. Aside from the recent jump in virus cases, further headwinds stem from still high unemployment, rising commodity prices feeding into inflation, and stagnant wages, reflecting ongoing weakness in domestic employment.

OPEC+ eases output cuts despite demand concerns

Oil prices settled lower at March's close, amid worries over oil demand following the re-imposition of Covid lockdowns in parts of Europe and as crude purchases in the Far East slowed. Brent crude dropped 3.9% m/m to $63.5/bbl, its first monthly decline since last October, reacting negatively on its final day to OPEC's downgrade to global oil demand growth in 2021 by 300 kb/d to 5.6 mb/d. (Chart 4.) Resurgent Covid-19, uneven vaccine rollouts and inflationary pressures were cited.

Chart 4: Brent crude oil price

($ per barrel, end of month*)

Source: Refinitiv * Latest figure is for April 9

Much to the market's surprise, rather than roll over the output cuts, OPEC+ opted instead to ease them over three months. The schedule will see OPEC+ increase production by 350 kb/d in May, 350 kb/d in June and 450 kb/d in July. Saudi Arabia will also restore its 1 mb/d of additional, voluntary cuts at the rate of 250 kb/d in May, 350 kb/d in June and 400 kb/d in July. This will resupply the market with more than 2 mb/d of crude by end-July, bringing aggregate OPEC+ supply back up to 36.34 mb/d and in line with the original OPEC+ schedule. Counterintuitively, oil prices actually gained on the day of the announcement; markets appeared to interpret the move as sign of OPEC's confidence in the near-to-medium term demand outlook.

Since the start of April, however, prices have been range-bound, with positive catalysts, such as the Biden administration's economic stimulus package and the IMF's upgrade to world economic growth this year balanced by bearish forces, mainly concerns about the robustness of economic growth amid persistent mobility restrictions. News that Iran and the US were engaged in indirect talks over restoring the nuclear agreement in some form is also leading to renewed oversupply worries.

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