EMBARGOED UNTIL: 11.30AM THURSDAY 11 MARCH 2021

THE FORWARD VIEW – GLOBAL

MARCH 2021

US fiscal stimulus to add further impetus to global economic recovery

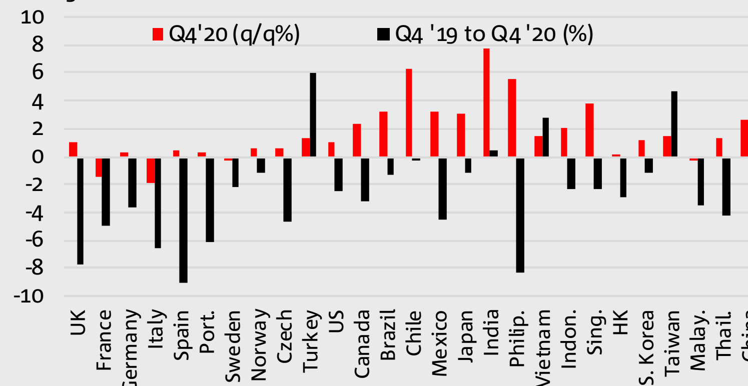
- A resurgence in the spread of COVID-19 across many parts of the globe towards the end of 2020 impacted the global recovery but did not derail it. Most countries experienced a rise in GDP in Q4 2020 with some European countries the main exception.
- While the restrictions put in place over late 2020/early 2021 to combat COVID-19 will also affect Q1 growth, 2021 is shaping up as a strong year. A reduction in COVID-19 cases, vaccines being rolled out, loose monetary policy settings and, particularly in the US, continuing fiscal support will all support growth. In many advanced economies, overall indicators of household and corporate health ended the year in good shape, which will also support the recovery.
- There was a large fiscal stimulus in the US in late 2020 (over 4% of GDP) and an even larger package (around 9% of GDP) is likely in coming days. This is much larger than we had been assuming, so we have revised up our US forecasts significantly (from 5.0 to 6.0% in 2021). As a share of the global economy (measured in $US terms) the combined value of the two stimulus packages is a notable 3% of global GDP.
- Bond yields have risen globally, partly on the back of higher growth and inflation expectations. This has negatively impacted equity markets and also seen some rise in volatility. However, overall, financial conditions still appear accommodative and whether central banks chose to respond will depend on how far bond yields rise and why.
- Overall, we now expect global GDP growth of 6.2% in 2021 (previously 5.8%). For 2022 we still expect 4.6%. With vaccine roll-out still at an early stage in most countries, the risk of another COVID-19 wave cannot be ruled out. The rise in bond yields may also put pressure on some EM economies, and how (and when) governments start to repair their fiscal positions will be important to watch. Inflation concerns are more a medium term risk; for now the major central banks would be happy to see a rise in inflation (currently below target) and will maintain very loose monetary policy settings.

Global Growth Forecasts

(% change)

	2018	2019	2020	2021	2022
US	3.0	2.2	-3.5	6.0	3.9
Euro-zone	1.9	1.3	-6.8	4.7	4.3
Japan	0.6	0.3	-4.9	4.1	2.3
UK	1.3	1.4	-9.9	5.5	6.8
Canada	2.0	1.9	-5.4	5.9	3.8
China	6.8	6.0	2.3	9.5	5.8
India	6.7	4.7	-7.0	10.0	5.7
Latin America	1.1	0.2	-6.8	4.4	3.3
Other East Asia	4.2	3.4	-3.1	5.5	4.9
Australia	2.8	1.9	-2.4	4.6	2.5
NZ	3.4	2.3	-2.4	4.5	4.4
Global	**3.5**	**2.8**	**-3.4**	**6.2**	**4.6**

Recovery generally continued into Q4 (Europe main exception)



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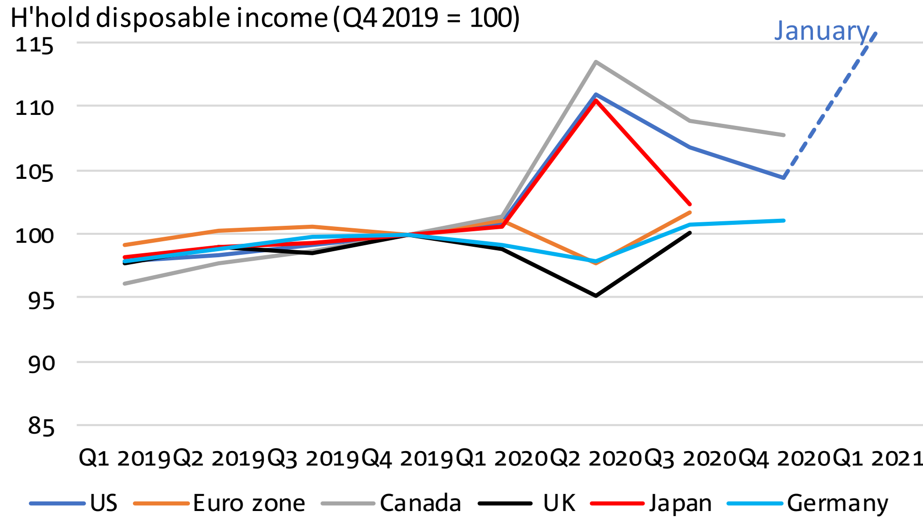
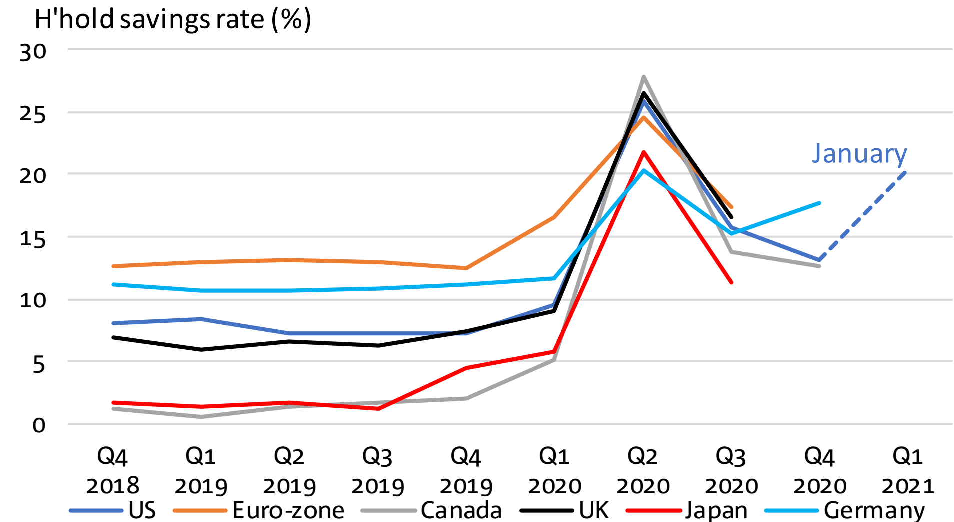
CHARTS OF THE MONTH (1) - HOUSEHOLD FINANCES

Boosted by govt support, household finances recovered quickly and, with spending down, savings spiked. Query over what happens as fiscal support fades and mortgage forbearance ends. Aggregates will mask a lot of individual variation.

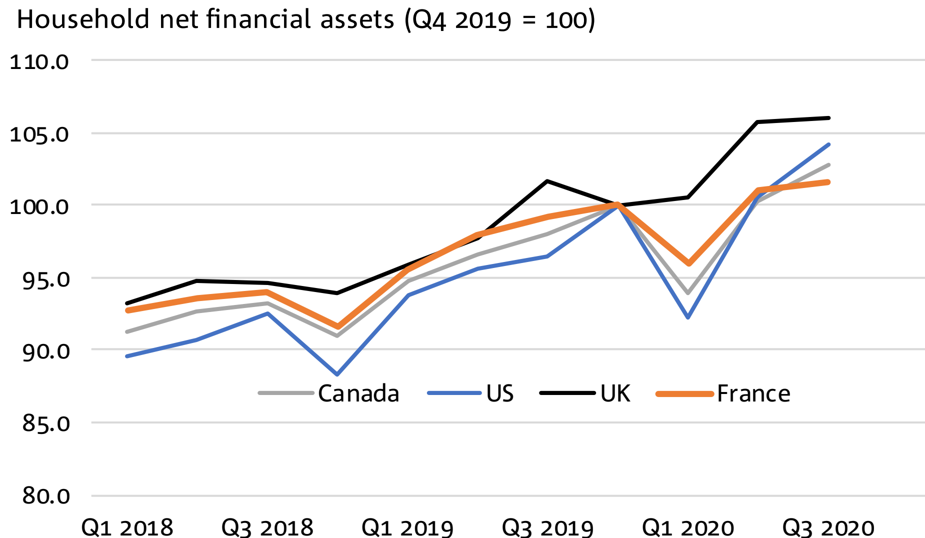
Fiscal support meant household incomes either recovered quickly or moved well above pre-COVID levels. Late 2020 round of US stimulus already apparent



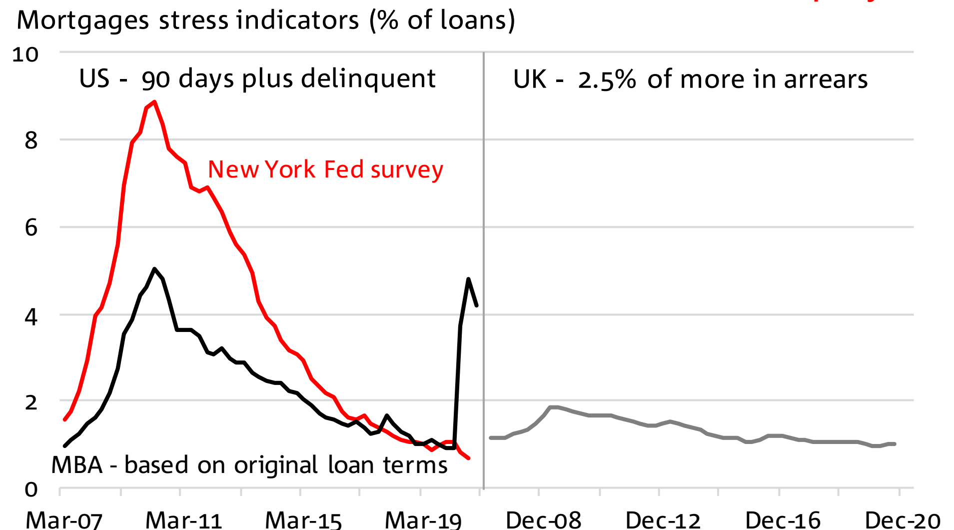
With spending collapsing in first half of the year savings rates jumped…typical in recessions but not to this extent



As with incomes, household wealth recovered quickly



Mortgage stress low helped by forbearance; potential problem down the track when forbearance ends if unemployment is high



 Sources: Refinitiv, New York Federal Reserve, Cabinet Office (Japan), NAB Economics

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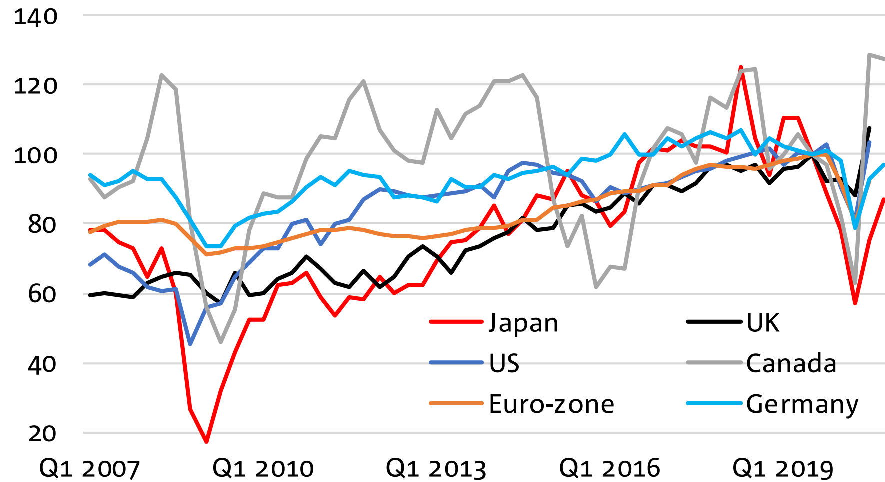
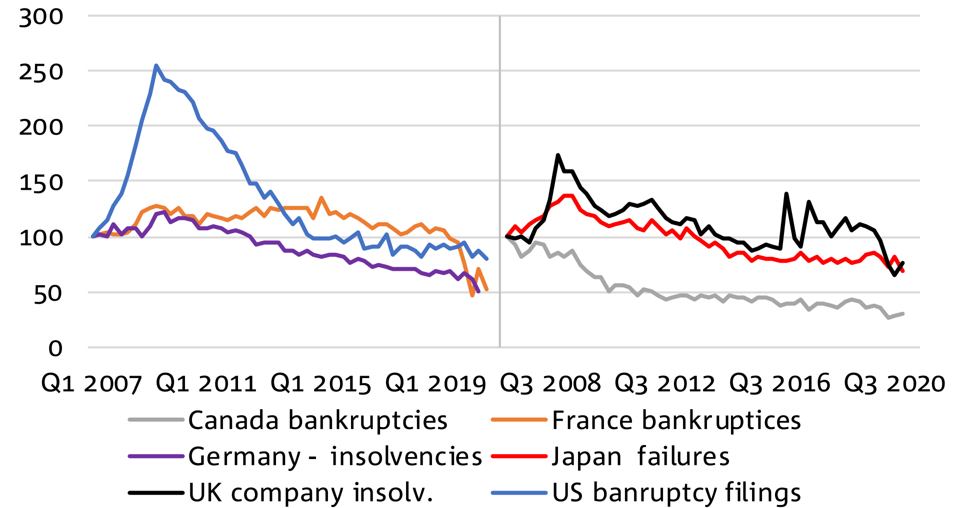
CHARTS OF THE MONTH (2) - MEASURES OF CORPORATE HEALTH

Profit recovery well underway by Q3, bankruptcies subdued while new start ups, if anything, higher. Increased lending but also increased cash on hand. But aggregates likely hide large sectoral divergence.

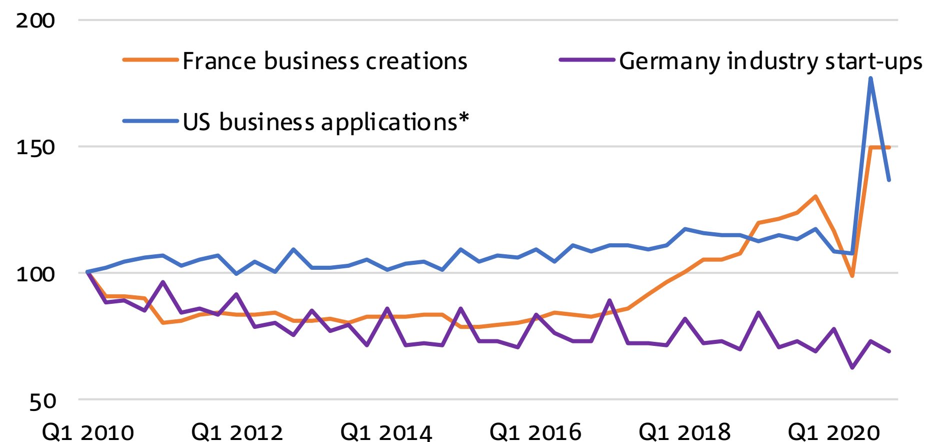
Profit recovery over Q3, Q4 – UK, Canada & US (with gov't support) back to pre-COVID-19 level



No pick up in business bankruptcies...yet

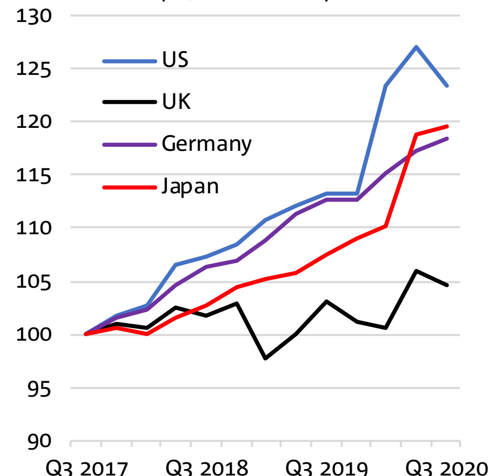


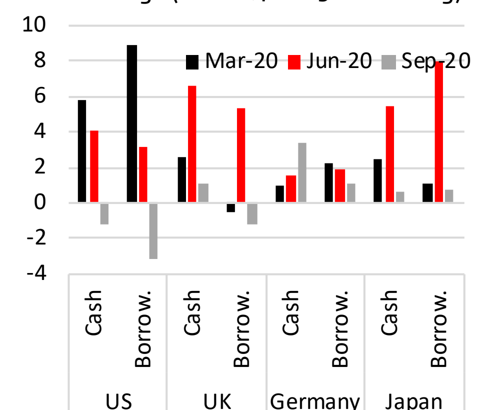
Business creation quickly back on track...if not above pre-COVID level



* 'High propensity' indicator

Corporate borrowings picked up notably in some countries...but matched by a build up in cash holdings





* Cash includes deposits, borrowings include loans and debt securities

 Sources: Refinitiv, US Census Bureau, NAB Economics

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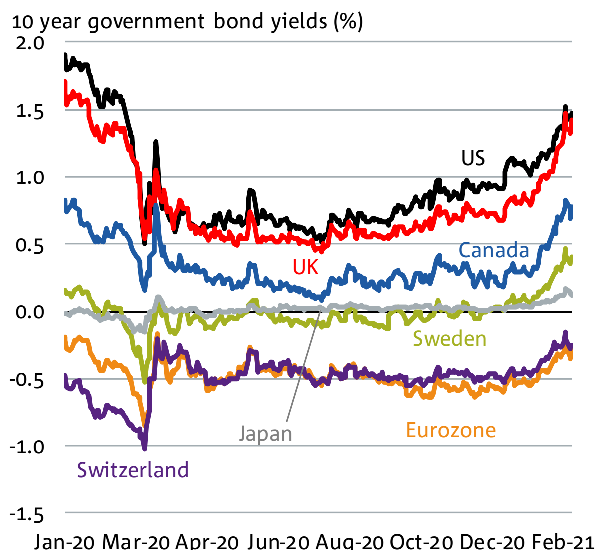
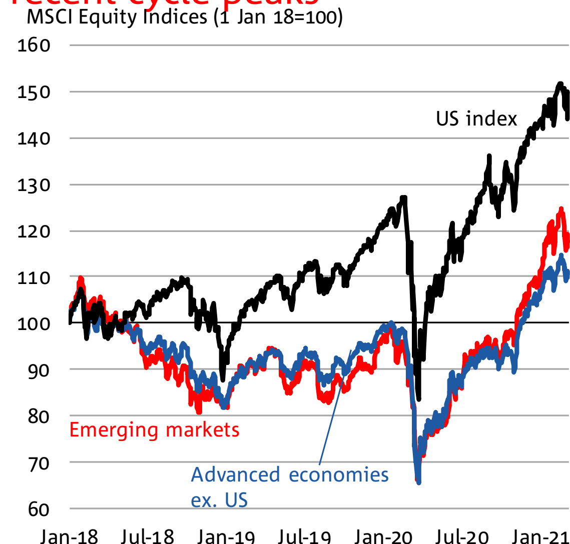
FINANCIAL AND COMMODITY MARKETS

Inflation fears sparked a surge in bond yields, causing jitters across financial markets

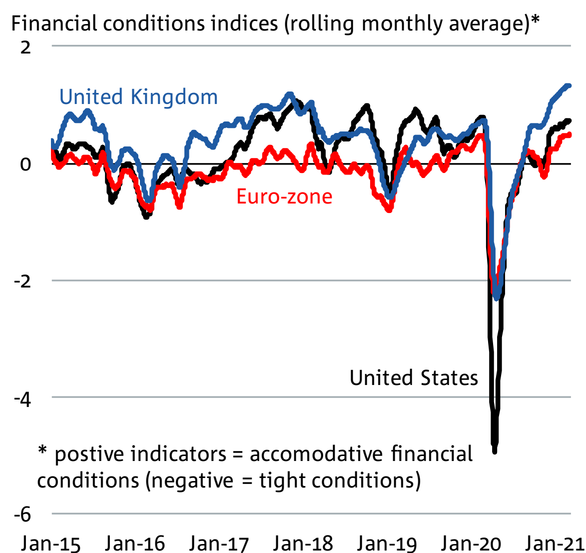
Bond yields surged from mid-February on inflation fears



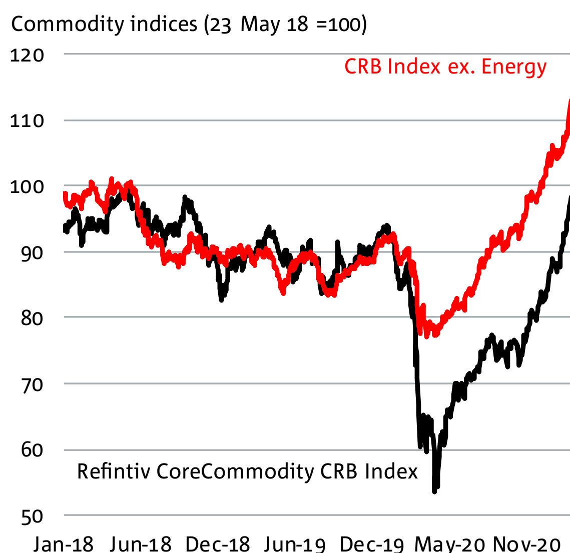
Equity indices have fallen from recent cycle peaks



Financial conditions remain accommodative



Commodity markets continue to recover, particularly ex. energy



Sources: Bloomberg, Refinitiv, NAB Economics

- Bond market yields rose gradually across Q4 2020 and through January 2021, as markets started pricing in a strong economic recovery. However, yields surged from mid-February onwards.
- The roll-out of vaccines and the prospect of larger than previously expected fiscal stimulus in the US raised growth expectations and triggered fears around inflationary pressures, contributing to the bond sell off. US 10 year Treasuries rose to around 1.5% – a level last seen prior to the COVID-19 pandemic – with many other sovereign bonds returning to, or exceeding, their pre-COVID yields.
- Market commentary has likened the sell off in bond markets to the "taper tantrum" in 2013 but without a taper. So far the Federal Reserve has done little to calm markets with Fed Chair Powell only noting in early March that the volatility in the bond market having caught his attention.
- Despite these inflation concerns, we anticipate policy rates remaining low for the next two years, with major central banks continuing to provide monetary support via unconventional policy measures, such as asset purchases. In part this reflects the fact that inflation in major economies has been low for a while, the major central banks see some of the price pressures as temporary and, moreover, they would welcome a lift in inflation (even to above target levels in some cases). Markets continue to price stable policy rates for most major central banks for the foreseeable future.
- Rising bond yields appear to have impacted other markets – with equity markets in the United States, other advanced economies and emerging markets declining from recent cycle peaks in mid-February (despite the stronger economic outlook). There was also a modest (by recent historical standards) spike in the VIX volatility index.
- Despite the volatility in a range of markets, financial conditions indices, which combine a range of market indicators into a single measure, have steadily trended higher since mid-October – indicating more accommodative conditions.
- Commodity markets have continued to strengthen, having gained momentum since late 2020 on the stronger global economic outlook. The aggregate Refinitiv CoreCommodity CRB Index was at its highest level in late February since mid-2018. Excluding energy (reflecting the weakness in oil demand due to COVID-19 restrictions), the index was at its highest level since September 2014.

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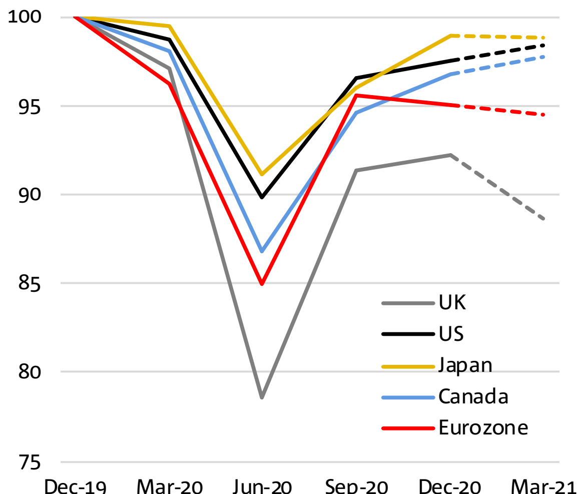
ADVANCED ECONOMIES

AE growth should strengthen over the year helped by fiscal stimulus and vaccine roll-out

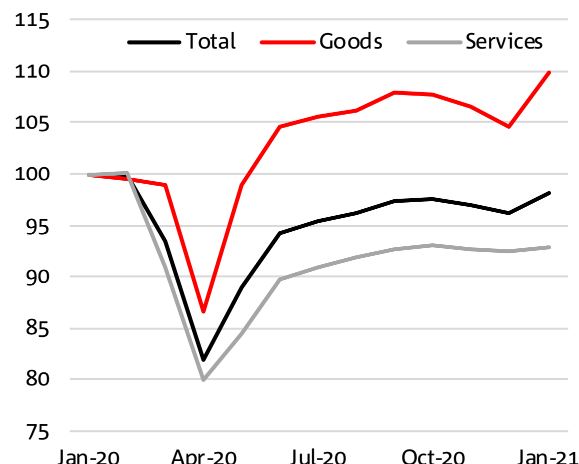
Recovery slowed (ex Japan) or reversed end '20/early '21

Major AE GDP (Q4 2019 = 100, dash line indicate forecast)



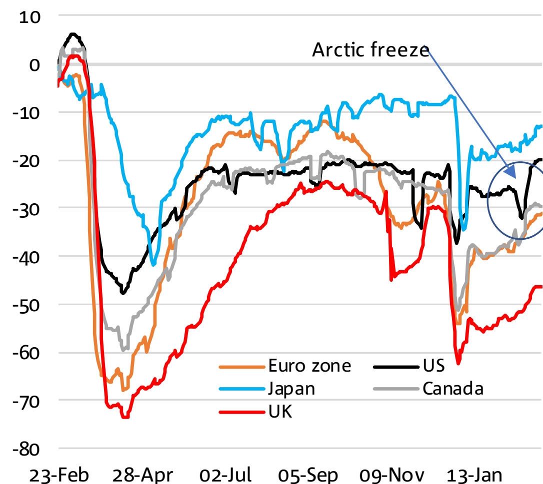
End 20 stimulus impact already evident in US with more to come

US Household consumption (Jan 2020 = 100)



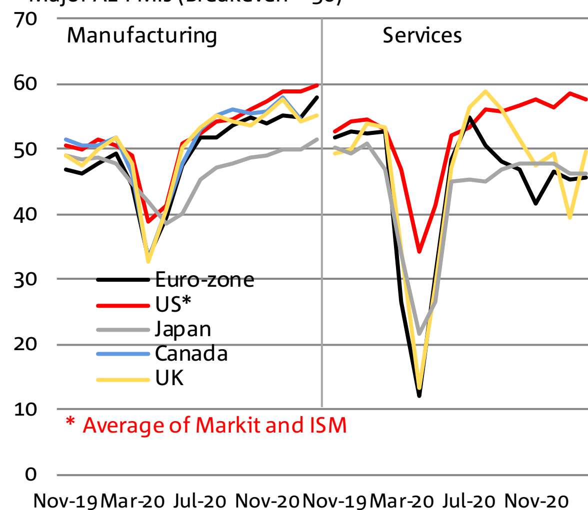
With falls in cases, signs mobility starting to recover

Google mobility (2020-2021): retail/recreation & workplace (% devn from baseline, 7 day average)



Business surveys – mfg strong; services indicators have troughed

Major AE PMIs (Breakeven = 50)



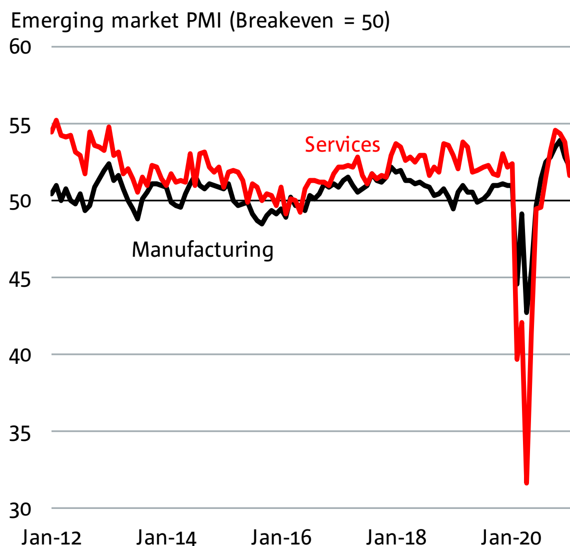
- Major advanced economy (AE) growth slowed towards the end of 2020 and into early 2021. With the latest wave of COVID-19 having receded, there has been some reversal of restrictions which will support growth heading into Q2. Fiscal support is another positive, particularly in the US where further stimulus is on the way. While the spread of the virus remains a risk, the roll-out of vaccines should eventually provide a more solid underpinning to the recovery. As a result, rapid AE growth is expected as the year unfolds.
- The major advanced economies (AEs) have now all reported Q4 GDP outcomes which generally surprised to the upside. Nevertheless, growth slowed materially from Q3 (or turned negative in the case of the Euro-zone) outside of Japan. This partly reflected a moderation in the pent up demand that existed post the initial lockdowns. It also reflected another COVID-19 wave and the re-introduction of activity restrictions. For Japan, this did not occur until January when a national emergency was declared in much of the country.
- The tightening in restrictions was most evident in Europe. As a result UK and Euro-zone GDP is expected to decline quarter-on-quarter in Q1. Restrictions continue to be extended in parts of Europe; there is talk Italy will tighten restrictions shortly, although the most recent German extension included some easing. The UK is planning to remove most restrictions by June, helped by its relatively rapid roll-out of vaccines.
- We currently have pencilled in a small fall in Q1 GDP in Japan, but it could easily be positive as strong industrial production may outweigh the hit to consumer spending. Moreover, the state of emergency declaration has recently been removed in parts of the country.
- Restrictions are also being eased in the US following the reduction in COVID-19 cases, with several states recently announcing a removal of restrictions. However, as for other countries, vaccinations aren't at the level needed to control the virus, so virus spread remains a risk. Q1 activity may also be held down by the mid-February 'arctic freeze'.
- US GDP is also being supported by the late 2020 fiscal stimulus. A further massive stimulus bill is likely to be signed-off soon. We had been assuming $1 trillion but now expect it to be around $1.9 trillion (around 9% of GDP). As a result we have substantially lifted our US GDP growth forecast for 2021 from 5% to 6%. Other countries continue to provide more modest fiscal support; the recent UK Budget included additional stimulus of around 2.5-3% of GDP in 2021-22 (see chart, page 7).

Sources: Refinitiv, https://www.google.com/covid19/mobility/, NAB Economics,

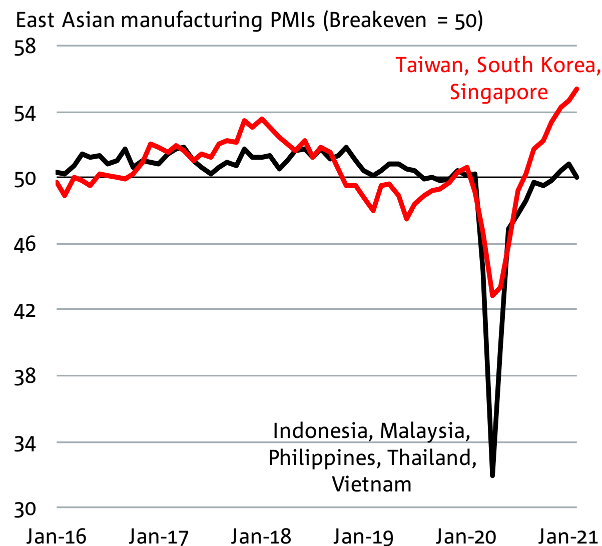
EMERGING MARKET ECONOMIES

Signs of softening in early 2021, with divergent trends by region

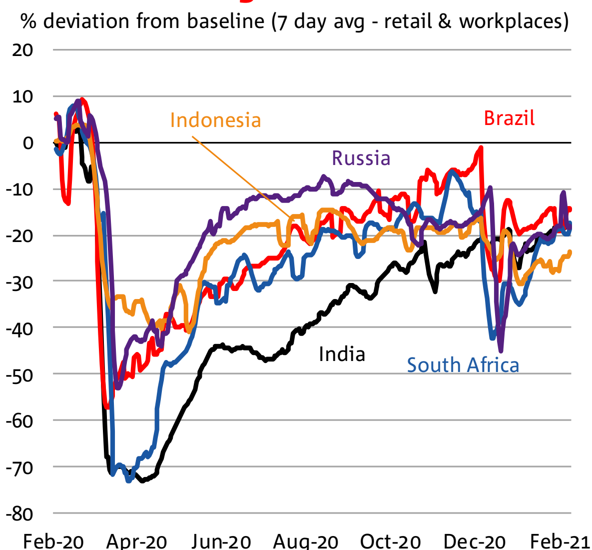
PMI surveys softening, led by weaker trends in China's results…



…with a clear distinction between higher and lower income markets



Google Mobility data consistent with softening trend



China the beneficiary of the trade recovery, other EMs still declining

 Sources: Refinitiv, Markit, Google, CPB, NAB Economics

- High frequency indicators continue to point to a gradual softening in conditions in emerging markets. The EM Manufacturing PMI eased in February, down to 51.5 points (from 52.1 points in January), continuing a trend evident since the recent cycle peak in November 2020. This decline was led by China, where the manufacturing PMI declined to 50.9 points (from 51.5 points in January), while India was relatively stable.
- Outside the two largest emerging markets, there has been a clear distinction between more advanced technology producers (which tend to blur the line between advanced and emerging markets), where manufacturing PMIs have continued to strengthen, while lower cost manufacturing EMs have remained near breakeven levels.
- In contrast, the EM services PMI edged a touch higher in February, up to 51.7 points (from 51.6 points in January). A decline in the Chinese and Russian services PMI was more than offset by a pickup in India.
- Google Mobility data appears consistent with the softening trend seen in manufacturing, with activity data in major EMs (excluding India) somewhat weaker in the early months of 2021 than in late 2020 (although it is worth noting that these data are not seasonally adjusted).
- India's economy grew strongly quarter-on-quarter in Q4 2020 but compared to Q4 last year was only up 0.4% a very weak outcome by historical standards. For the full year, Indian GDP contracted by around 7%, but growth is forecast to rebound strongly in 2021 – with base effects due to the incredible plunge in output in Q2 2020 set to drive growth in 2021 higher..
- At China's National People's Congress in early March, Premier Li announced a surprisingly weak 6% growth target for 2021. Although this level is typical of earlier, pre-COVID-19 targets, base effects should push China's growth considerably above this rate in 2021.
- According to CPB data, emerging market trade volumes rose by around 2% yoy in December 2020 (following on from a 4% increase in November). That said, the increase in trade was not widespread, driven by increases in China – supported by demand for electronics and medical supplies – and to a lesser extent East Asian economies. While Chinese volumes rose by 8.3% yoy in December, volumes for other emerging markets fell by 2.1% yoy.

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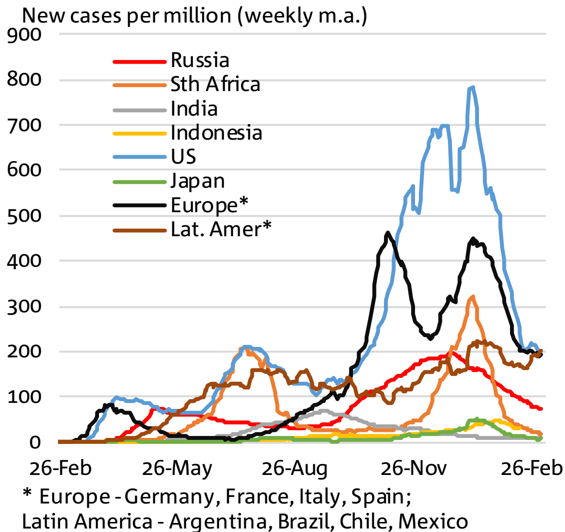
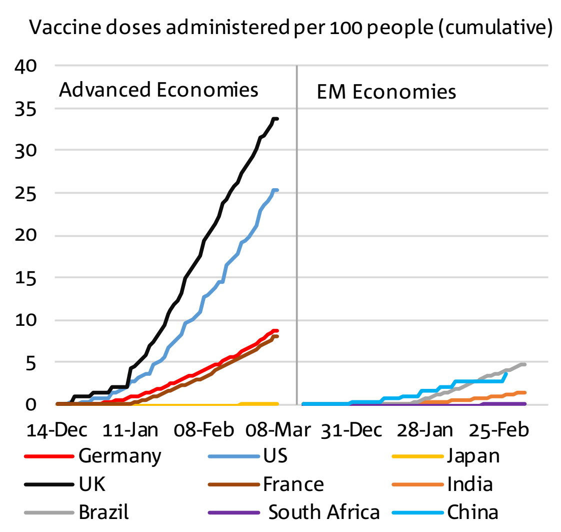
GLOBAL FORECASTS, POLICIES AND RISKS

Fiscal stimulus, vaccine roll-out and easing restrictions point to strong 2021 but risks remain

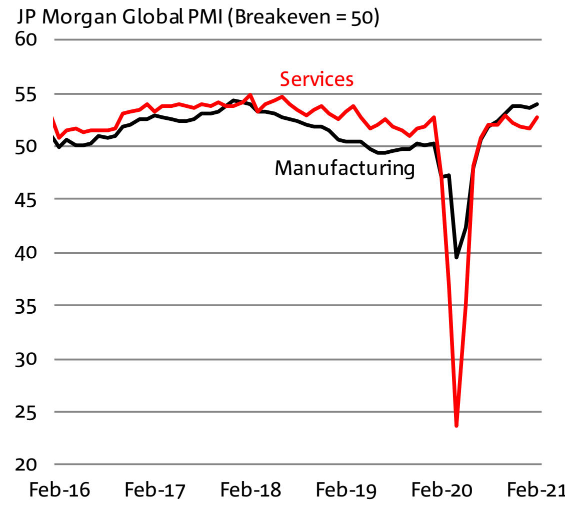
COVID-19 cases have fallen significantly...but until vaccination roll-out reaches a much higher level COVID-19 risk remains



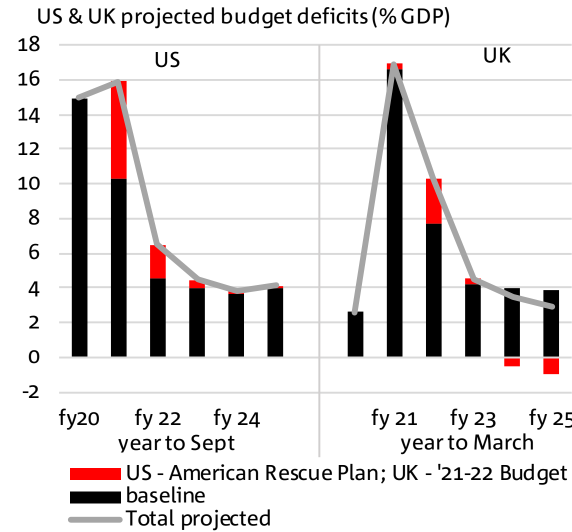
* Europe - Germany, France, Italy, Spain;
Latin America - Argentina, Brazil, Chile, Mexico



Surveys point to ongoing recovery particularly manufacturing



More fiscal stimulus but longer-term fiscal challenge



- Q4 GDP data indicate that the global recovery continued into late 2020 (see Chart on page 1), with Europe a key exception. This was despite a resurgence in COVID-19 cases which led to the re-imposition of restrictions in many countries. The impact on economies was much less than seen in March/April 2020 as restrictions were less synchronised across countries and more targeted, as well as due to business adaption.
- Similarly, the global PMI business surveys have remained above their break even level, although there was a temporary dip in the services PMI before recovering in February. Under this calm, however, European service PMIs fell well below breakeven and, more recently China and Brazil, have softened although for the former it likely reflects the fact that their recovery is largely complete, but this is being offset by a pick up elsewhere.
- Manufacturing has continued to outperform, as it benefits from a switch to goods consumption. World industrial production and goods trade in December was just above its year ago level. If anything the sector is being held back by supply issues – e.g. for semi-conductors and in shipping.
- A fall in COVID-19 case numbers is triggering an easing in restrictions in some countries (e.g. US, Japan) or plans to do so (e.g. UK). The roll-out of vaccines is helping underpin these moves but there is still a long way to go before there is widespread community vaccination. Most advanced economies will not see widespread coverage until late 2021, while middle income economies are unlikely to achieve this until late 2022. As a result another upturn in COVID-19 transmission remains a risk.
- The combination of easing restrictions, healthy household balance sheets (see page 2), further large scale stimulus points to rapid growth over the rest of 2021. The US is set to put in place another fiscal package soon. This follow up stimulus looks almost certain to be around $US1.9 trillion (around 9.0% of GDP) which is much larger than we had assumed. This is one reason why we have revised up our forecast of global growth in 2021 to 6.2% (was 5.8%) and still expect 4.6% in 2022.
- Apart from COVID-19 spread, there are other risks to the outlook. In the past rising bond yields have been associated with capital flow pressures on EMs (particularly those with large external imbalances). Governments have experienced a deterioration in their fiscal position and how (and when) this is addressed will be important to watch. The UK Budget acknowledged this reality by raising taxes down the track. Similarly, as repayment holidays and mortgage forbearance ends, there may be a disruptive rise in bankruptcies.

Sources: Refinitiv, Our World in Data, UK Government, Congressional Budget Office, NAB Economics.

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