Investec
Investec Bank plc (UK)

25 August 2021

Economics

Global Economic Overview

Past the growth peak, but still elevated

Global

Over the last month global growth concerns have caused some volatility in markets. Supply chain disruptions continue to hold back output growth, while fears over the spread of the Delta variant have dampened confidence a little. Despite this, we still believe that the global economic recovery maintains momentum, pencilling in global growth of 5.9% in 2021 and 4.7% in 2022. Previously we had 6.2% and 4.9%.

United States

A disappointing Q2 GDP outturn has been coupled with softer indicators for Q3, seemingly related to the Delta variant and supply difficulties. Accordingly we have brought our growth forecasts down to 6.2% for this year and 4.3% next, from 7.3% and 4.8% respectively. Ahead of the Jackson Hole conference, we stand by our view that the FOMC will announce a tapering of its QE programme in December. We still consider the current upsurge in inflation to be transitory. Nevertheless we recognise that the current run of high numbers means that the 5-year average for the core PCE measure is approaching 2%. Meanwhile, President Biden's fiscal stimulus plans are progressing. House Democrats have (for now at least) set aside their differences and passed the $3.5trn Budget resolution, with an agreement to vote on the infrastructure bill in September.

Eurozone

Now that vaccination rates have surpassed US and in some cases even UK levels, economic activity in the eurozone is recovering strongly, also to the benefit of labour markets. We have raised our forecast for GDP growth for this year to 5.2% and for next year to 4.8%. As elsewhere, inflation has mounted and looks poised to jump well above target for a while. Although the ECB's HICP forecasts may soon be revised up, the Governing Council will take longer to be convinced that the inflation trend will durably stay at target. As a result, policy tightening, in our view, will not begin until Q4 2023. But the rate at which stimulus is being added to may ease shortly: to us, the conditions to maintain the stepped-up pace of PEPP purchases relative to January and February this year no longer seem to be in place.

United Kingdom

GDP growth has probably passed its peak, now that unlocking is complete. However, even with our now slightly lower growth forecasts of 6.7% for this year and 5.2% for 2022, there still appears to be plenty of momentum in activity. Not only do consumers have ample savings, but upbeat business sentiment may encourage firms to invest more too. But hopes that the end of the furlough scheme can pass without any rise at all in unemployment may be a little too optimistic, in which case wage pressures may be more contained than some fear. Still, monetary tightening looks likely to begin as soon as in Q2 next year. The Bank of England has made clear that rate hikes will be its initial instrument of choice, which will be followed by some automatic runoff in its balance sheet before outright gilt sales are considered.

Please click here for a summary of our economic and market forecasts

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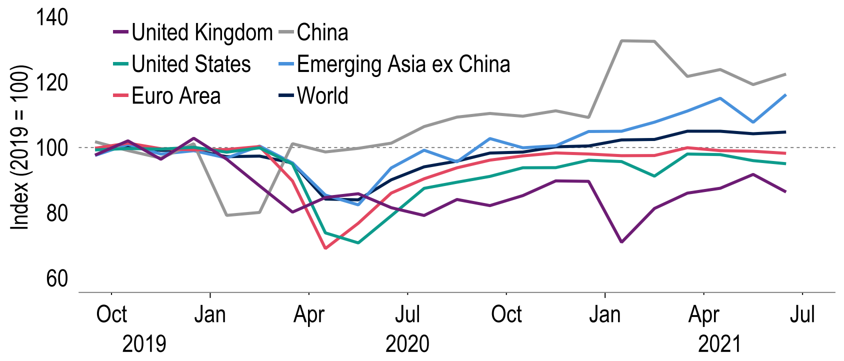
Global

High demand for goods has been a defining feature of the world economy in the pandemic. A key beneficiary has been exports from Asia – mainly China, but also other emerging Asian nations. Lately, the major developed countries too have seen export volumes back to, or nearly back to, their 2019 mean (Chart 1). This is despite supply bottlenecks hampering production relative to demand, and despite the cost of international trade rising with sharply higher shipping costs. As the unlocking of economies allows for a shift in demand away from goods and towards services, supply bottlenecks should ease, which may sustain goods trade despite the demand rotation.

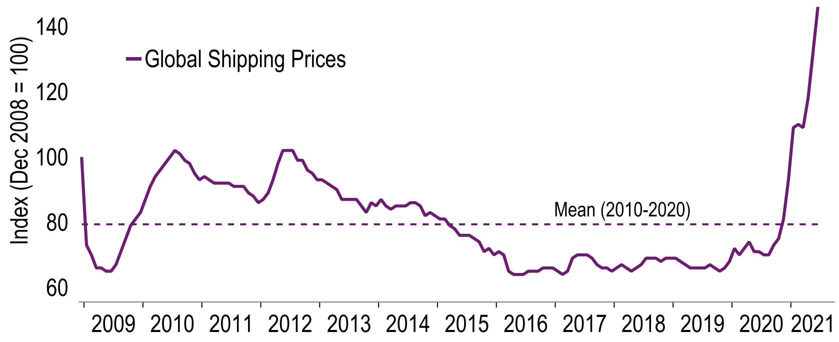
Chart 1: Export volumes have recovered across the world to, or near, pre-pandemic levels



Source: CPB, Macrobond and Investec

But surging shipping rates may take longer to unwind. Over 80% of internationally traded goods were carried by sea prior to the pandemic. With less air travel, fewer alternative cargo options remain available, keeping up demand for shipping. Meanwhile, supply disruptions persist, not least as port efficiency has declined dramatically in light of Covid outbreaks affecting staffing and leading to port congestion. In turn, delays have prevented container ships from calling at some ports and hindered the efficient distribution of empty containers. High industry concentration in shipping may have added to prices. The price surge has encouraged shipbuilding, but it will be 2023 until much of it is ready for use.

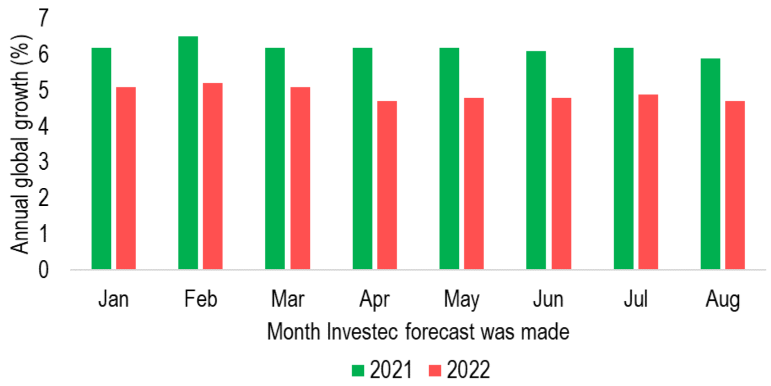
Chart 2: The surge in global shipping prices, unabated so far, may persist for longer



Source: Container Trades Statistics Ltd, Macrobond

In recent weeks global growth concerns have intensified. Although we have downgraded our 2021 forecast by 0.3pp, we do not see this as cause to panic. The majority of the decline (0.2pp) is based on our view that the US economy reached 'peak growth' earlier than anticipated, and as such it is natural to see a slight slowdown in momentum, as economic activity returns to more normalised levels. Elsewhere, the UK presents a similar story, while the short-term outlook for China and Australia has been dampened by new Covid-19 restrictions. As shown in Chart 3, despite some market growth concerns, our outlook has not changed materially from January.

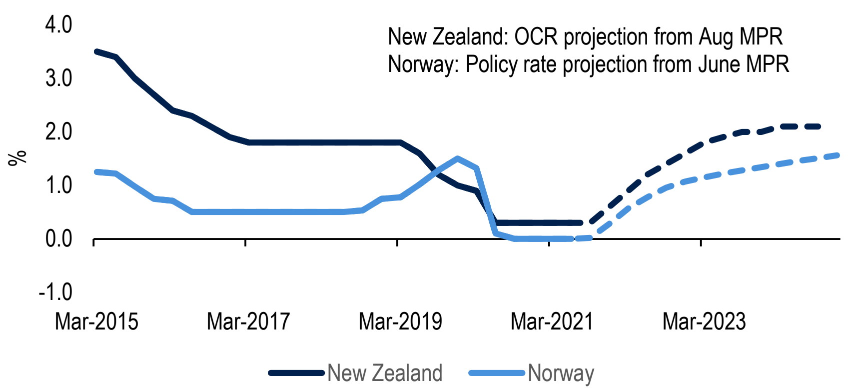
Chart 3: Fast-forward eight months and do you get déjà vu?



Source: Investec

Amid these positive economic conditions, the focus among many major central banks is on scaling back or even reversing monetary stimulus. Attention is centred on any signals Fed Chair Jay Powell will send at the 26-28 Aug (virtual) Jackson Hole Symposium that may clarify the conditions and the timeline the FOMC has in mind for tapering and hiking. But some of the smaller G10 central banks are further ahead: on 19 Aug, the Norges Bank reaffirmed its intention to raise its policy rate gradually from September. The RBNZ, meanwhile, which has already ended QE and was poised to hike this month, has put this on hold for now in light of the first local Delta Covid cases being detected, but still plans to hike (Chart 4).

Chart 4: Norway's and New Zealand's central banks are planning on hiking policy rates soon



Source: RBNZ, Norges Bank and Investec

China's policymakers, however, are in a different position. Following the cut to the RRR last month, speculation has been mounting in regard to a further easing in policy before the end of the year. These expectations have intensified following a disappointing set of activity data for July and an increase in Covid-19 cases, which have fuelled economic growth concerns within China. Although any further policy adjustment is expected to target liquidity pressures in light of an increase in maturing MLF loans (Chart 5), the PBoC may also use its tools to shore up flagging growth. Considering the risks to the near-term recovery, we have downgraded our 2021 GDP forecast by 0.4pp to 8.1% y/y.

Chart 5: Are the CNY3trn of maturing loans the only reason that the PBoC has tilted to easing?

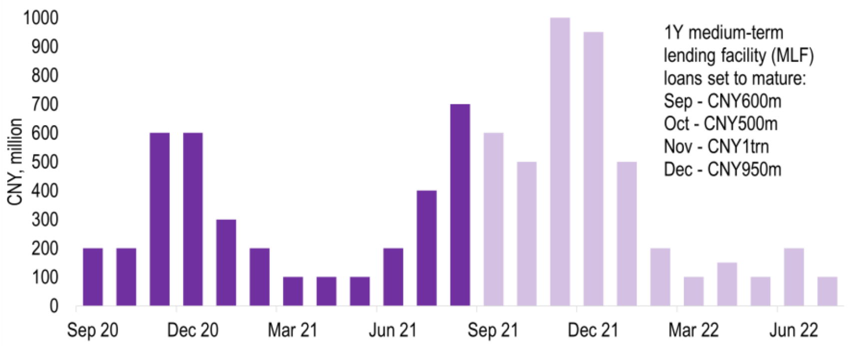
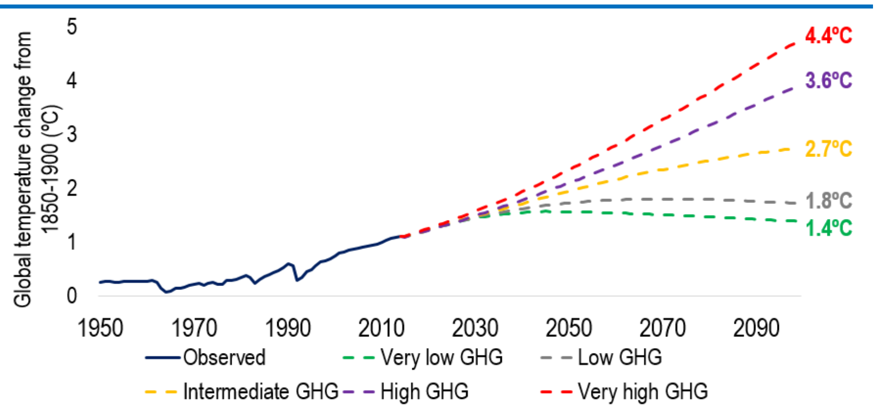


Chart based on official 1-year medium-term lending facility operations, lagged by one year Source: Macrobond

A perceived longer-term risk to the global economy remains the threat from climate change. A new IPCC report has suggested that global temperature rises will exceed the critical 1.5ºC threshold by 2040. This stark warning comes as the UK prepares to host COP26, in which 190 leaders will discuss climate action. During COP21 the Paris agreement was born, in which leaders committed to set out how they will each reduce emissions, and to work towards a collective aim of limiting global warming to 1.5ºC. These national plans are up for renewal at COP26, with much starker commitments needed to have any chance at the 'low emissions' IPCC scenario, in which global temperature increases settle below 1.5ºC.

Chart 6: IPCC report delivers stark warning on climate change

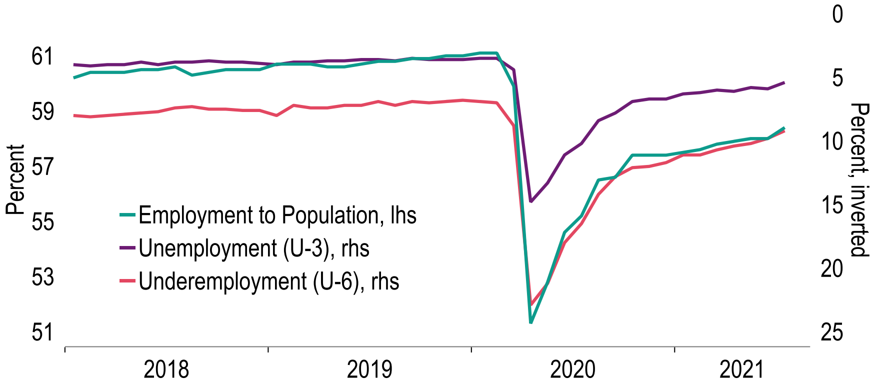


GHG – Greenhouse gas emissions Source: IPCC, Investec

United States

GDP rose by a disappointing 6.5% (saar) in Q2. An inventory drawdown contributed to the relative sluggishness – excluding stockbuilding, 'final sales' rose at a brisker pace of 7.7%. Even so, surveys relating to Q3 point towards cooler conditions than we had expected, with the Delta variant at least partly responsible. We have trimmed our GDP forecasts to 6.2% this year and 4.3% next (from 7.3% and 4.8%). For now the jobs numbers have remained strong. In terms of unemployment, the headline U-3 rate now stands at 5.4% (pre-pandemic low 3.5%) and the broader U-6 rate at 9.2% (6.8%). Fed members are paying close attention to the employment to population ratio, which is 2.7% pts below its 2020 highs (Chart 7).

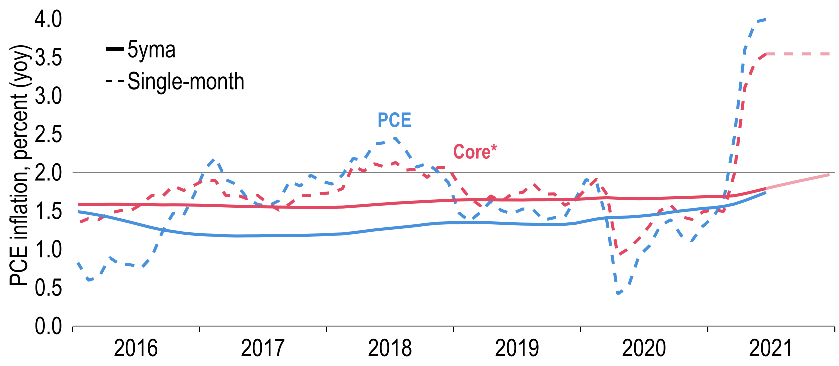
Chart 7: The US labour market has recovered, but not yet fully



Source: Macrobond

The FOMC's broad conclusion is that its jobs aim (maximising employment) is not yet reached. But most members seem to judge that its price objective (in essence, pushing inflation up to 2%) is now met. As we have noted previously, the prevailing rate of inflation matters, as the Fed's 'make up' strategy is to achieve an average of 2% over time - a higher rate of inflation now should compensate more for a prior undershoot, prompting the committee to dial back its stimulus earlier. There is no set formula for averaging, but Fed members have alluded to 5-year timeframes. Hence were June's core PCE measure to remain at 3.5%, the average would reach 2.0% at the end of this year.

Chart 8: Recent elevated inflation is dragging the five-year average up to 2%

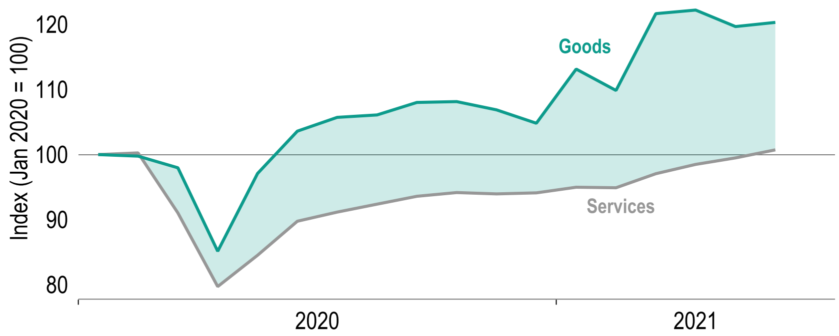


*Core PCE excludes food and energy prices

Source: Macrobond

However we stand by our view that inflation will subside over the next year. According to July's CPI, annual second-hand car inflation remained at 42%, but the monthly increase was just 0.2%, with data from car auctions hinting at subsequent declines. But at least up to June, business inventories remained at low levels – at 1.25, the stock/sales ratio was 0.1% away from a series (29-year) low. Slower demand (July's retail sales fell by 1.1%) will help, although component shortages (e.g. semiconductors) continue to constrain output. Another factor dragging inflation down is the substitution of spending on goods by expenditure on services as the economy reopens, though the current trend is gradual (Chart 9).

Chart 9: The void between US personal spending on goods and services is gradually closing



Source: Macrobond

With the latest FOMC minutes confirming that the majority of members viewed that tapering QE was likely to be appropriate by end-year, attention is turning to what this taper could look like. In recent weeks some Federal Reserve members have been advocating not only an earlier taper, but also a faster taper than the 10 months it took in 2014 (Chart 10). Our own view is that the Fed will announce tapering in December and that this process will last for nine months, possibly six, depending on the economic data. This would provide the central bank more flexibility to raise interest rates at an earlier stage, if appropriate. However, our central case is that we will not see a rate hike until Q1…

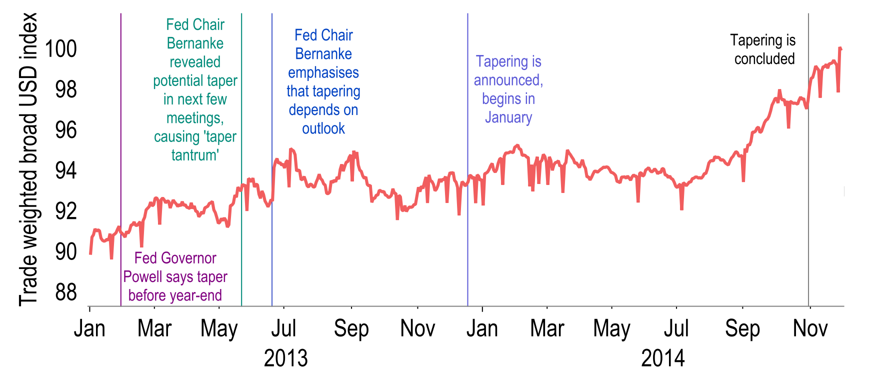
Chart 10: Some Fed speak indicates an early and fast taper

Boston Federal Reserve President Rosengren (voting member) — 'If we get another strong labour market report, I think that I would be supportive of announcing in September that we are ready to start the taper program' – 16/08/21	*St Louis Federal Reserve President Bullard (voting member)* — 'My plan is to taper earlier and faster, putting the Fed in a better position to battle high inflation in 2022' – 20/08/21
Atlanta Federal Reserve President Bostic (voting member) — 'I would be in favour of completing the taper in a shorter period than what was done in previous rounds.' – 09/08/21	*Dallas Federal Reserve President Kaplan (non-voting member)* — 'I would be in favour of announcing a plan at the September meeting and beginning tapering in October…I would like to taper over approximately eight months' – 11/08/21

Source: Investec, Reuters

…2023 – in the interim we expect the USD to lose some ground. Principally, we imagine that markets will have largely priced in tapering prior to the event. Indeed, we saw volatility leading up to the 2014 taper, and in recent months the USD has rallied on the outlook for tapering. We also expect the dollar's major currency pairs to exhibit strength over the forecast horizon. Our view is that the US economy has already passed peak growth, allowing room for other currencies to 'catch up'. Moreover earlier timelines for ceasing QE relative to the Fed should provide support to the likes of GBP and EUR. As such, our year-end EURUSD and cable forecasts are $1.22 and $1.42, respectively.

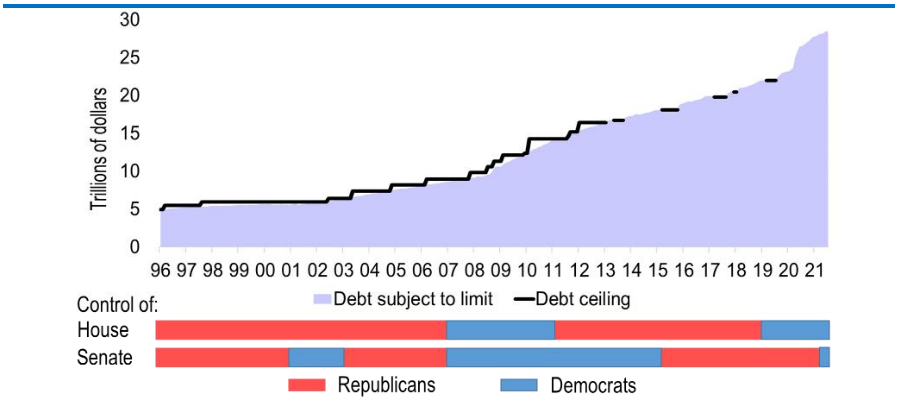
Chart 11: Impact of tapering hints on the dollar in 2013/14



Source: Macrobond, Reuters, Investec

President Biden's stimulus plans are progressing, with both the infrastructure bill and the $3.5trn budget resolution framework advancing through Congress. Still, the road ahead is bumpy, especially with sparring within Biden's own party threatening to derail the passage of the bills. On top of this, political tension has arisen regarding the debt ceiling. The Democrats have decided to seek Republican support to raise the ceiling, rather than pass it through reconciliation (via the Budget). Although a bipartisan deal was reached several times over the Trump presidency (Chart 12), the GOP has vowed not to help raise the limit. Without an increase in the debt ceiling, the CBO has estimated that the US will run out of funds by October or November.

Chart 12: The debt ceiling debate returns – will the GOP let the US default? Time is ticking

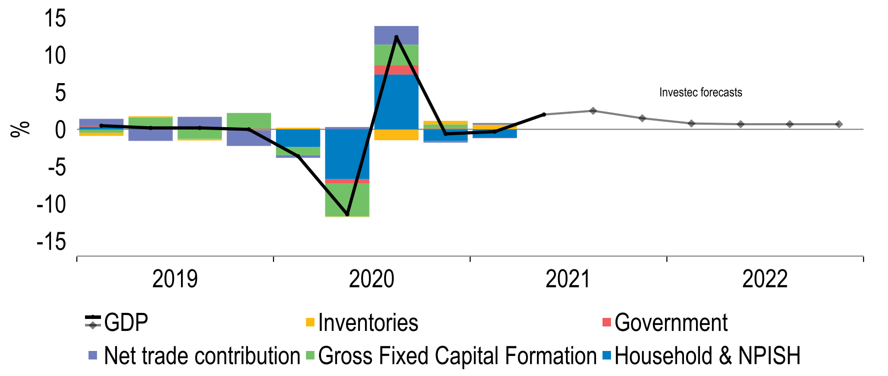


Source: Macrobond, Congressional Research Service, Investec

Eurozone

EU19 GDP expanded faster than expected in Q2, growing 2% q/q. There is no expenditure breakdown yet, but given the reopening of economies household consumption will have contributed, rebounding from its 2.2% decline in Q1. It should continue to play a part in the recovery story to come, supported by excess savings which have grown to €540bn* as of Q1 2021. However an additional support is set to be investment over H2, thanks to the EU's Next Generation stimulus, with the first funds totalling €46bn** having been disbursed over the last month. The impact on growth will vary across countries given differences in allocations, but on aggregate the cumulative uplift to growth could be as much as 1.5% by 2023***.

Chart 13: EU19 GDP growth (q/q) forecasts and breakdown by expenditure contributions

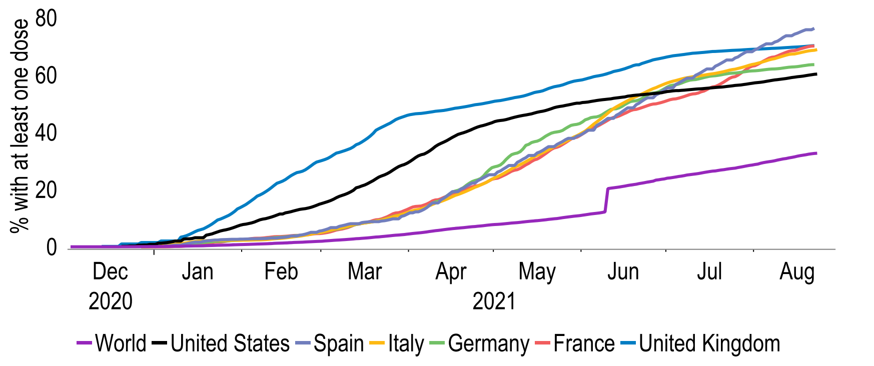


** Portugal €2.2bn, France €5.1bn, Italy €24.9bn, Spain €9bn, Greece €4bn, Belgium €770m, Luxembourg €12m
* & *** ECB estimates

Source: Macrobond, Refinitiv

Of course Covid and in particular Delta is the main risk to this outlook. But infection rates appear to be a slowing across many countries, now that vaccination rates surpass US and have reached UK levels (Chart 14). An added incentive for some to get vaccinated looks to have been the new requirement for 'vaccine passports' for entry to bars and restaurants in countries such as France. With this, so far economic activity has managed to escape Delta unscathed: indicators such as Google mobility and 'traditional' measures such as the PMIs have remained firm. Our own GDP forecasts have been revised upwards, principally due to the strong Q2, to 5.2% for 2021 and 4.8% for 2022.

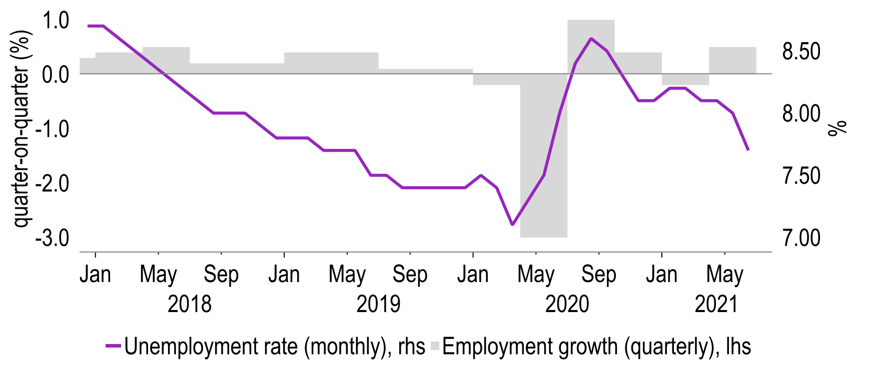
Chart 14: Euro area vaccination rates surpass those in the US and have caught up with the UK



Source: Our World in Data and Macrobond

As elsewhere, against the pandemic backdrop the labour market has shown resilience, and more recently an improvement, the unemployment rate falling to 7.7% in June from a peak of 8.6% in August 2020. That puts it just 0.6%pts above the record low of 7.1% seen just before the onset of Covid (Chart 15). Of course short-term job schemes have had a significant influence in backstopping jobs. At present some 5% of the EU19's workers are still on such schemes. But with the recovery gaining traction the improvement should continue. Certainly the most recent indicators have suggested so, with employment rising 0.5% in Q2 and the PMI employment index at its highest in almost 21 years.

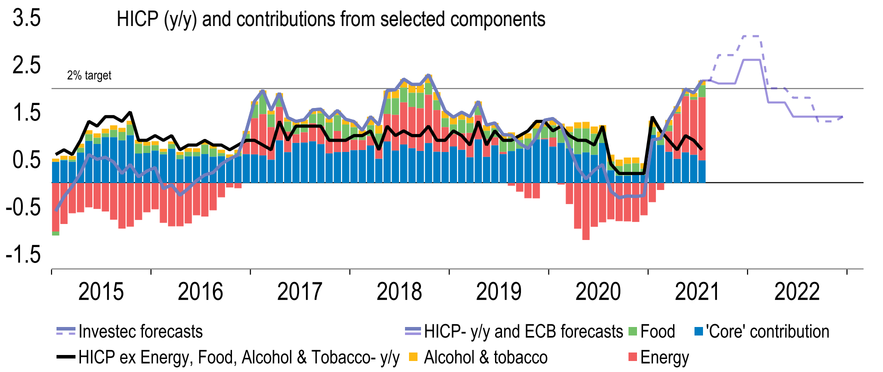
Chart 15: The labour market recovery has gained pace in the euro area



Source: Eurostat, Macrobond and Investec

Inflation in the Euro area, as elsewhere, has been firming in recent months, July's reading of 2.2% the highest since 2018. A number of base effects and changes in German VAT rates have been significant contributors. However we expect that inflation still has further to run and could see HICP reach 3.1% in Q4 2021 (Chart 16). As such we judge the ECB's own forecasts to be too low and see the risk of an upward revision in September. Given the ECB's updated policy guidance, there is now additional emphasis on these. However even with upward revisions, the three conditions for tightening interest rate policy are still likely to remain far from view, arguing for policy to stay accommodative. But whereas any…

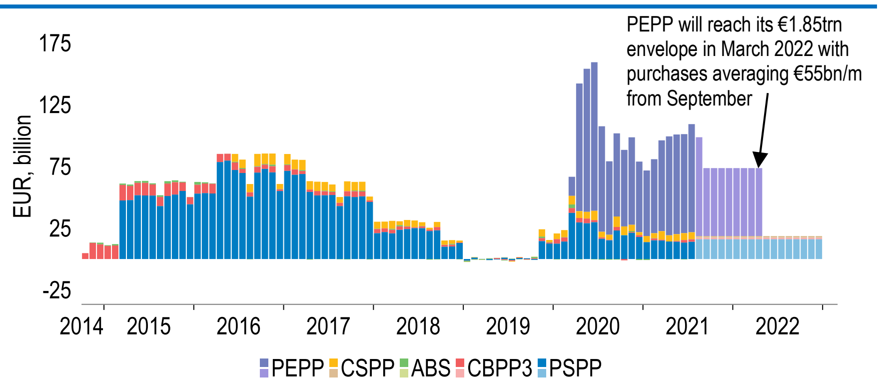
Chart 16: HICP inflation expected to rise further before moderating in 2022



Source: Eurostat, ECB, Investec and Macrobond

… change in interest rate policy is not on the horizon, there is an immediate question over asset purchases. In June the ECB announced that it would maintain the faster rate of purchases under PEPP for another quarter. A decision on whether this will continue will therefore be necessary next month. Given the better than expected reading on Q2 GDP, prospects of a strong Q3 and financing conditions which are arguably more favourable than in June, we suspect that the ECB will judge that the stepped-up pace is no longer required and instead revert back to the rate in January and February. That would still leave the ECB buying €75bn a month across the APP (€20bn) and PEPP (€55bn) (Chart 17).

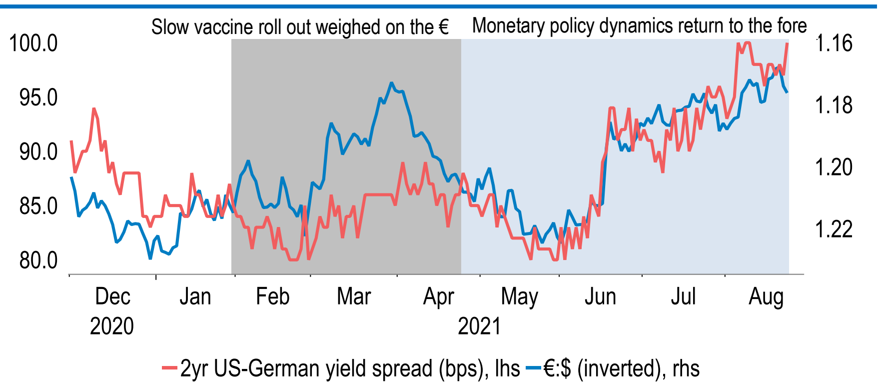
Chart 17: Will ECB monthly asset purchases continue at their stepped-up pace?



Source: ECB, Investec and Macrobond

This more dovish stance compared to the Fed and the BoE has been a factor weighing on the euro, which has fallen 4.4% year to date. A slow vaccination rate through the earlier part of this year also represented a drag. However we still see the euro recovering its losses through the remainder of this year, with our year-end target unchanged at $1.22. This is based on the view of a 'catch up' in the Euro area given the improving pandemic backdrop, where vaccination rates now exceed those in the US and activity is still picking up. Additionally whilst we suspect that a tapering of the Fed's asset purchase scheme is largely priced into the dollar, a gradual turn in ECB policy towards removing policy accommodation, first by slowing PEPP purchases, will likely give the euro some impetus.

Chart 18: Several factors have dragged on the euro so far this year



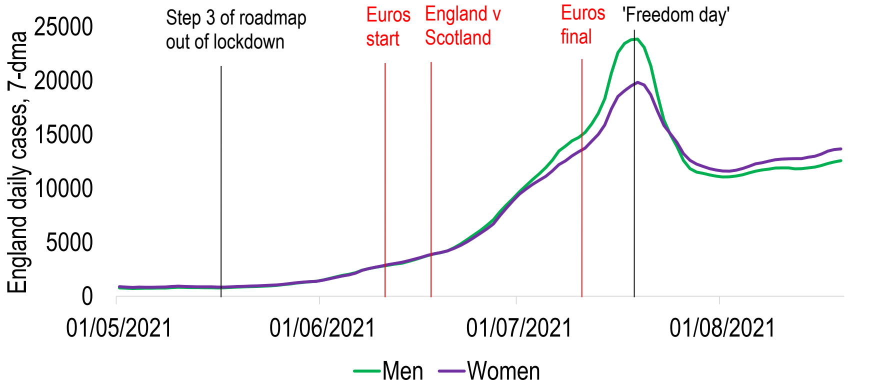
Source: Investec and Macrobond

Investec

United Kingdom

Evidence has accumulated that the surge in Covid cases in the UK through July was meaningfully boosted by greater social contact related to the Euro 2020 football championships. Not only did numbers decline soon thereafter, confounding expectations of further rises as legal social restrictions came to an end, but men – more likely to have watched – were disproportionately affected (Chart 19). The incidence of new cases has, however, recently stopped falling and resumed its slower pre-Euro 2020 uptrend. Still, confidence among scientists is mounting that, thanks to high vaccination rates, it will not be necessary to reimpose social restrictions later on.

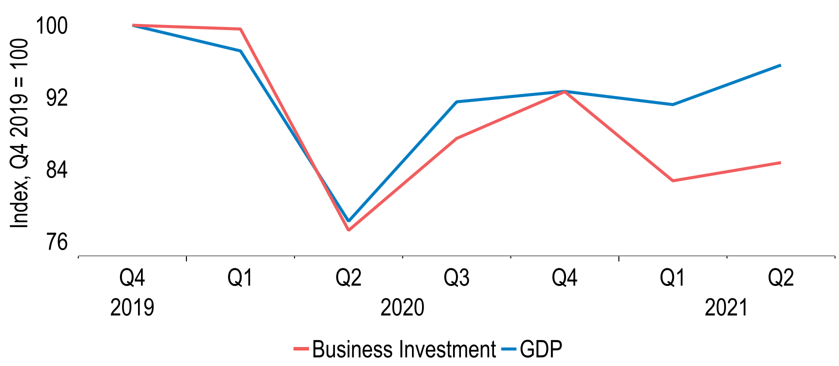
Chart 19: The Covid case surge looks to have been linked to the Euro 2020 football tournament



Source: Coronavirus.data.gov.uk and Investec

That, in turn, bodes well for UK GDP growth. True, now that the economy has fully unlocked, most 'low-hanging fruit' in terms of GDP growth has been picked. But although it is poised to slow, momentum in quarterly growth will stay solid in Q3: simply maintaining June's level of output throughout Q3 would give quarterly GDP growth of 0.9%. Yet without new social restrictions, further monthly growth can be achieved. Consumers still have plenty of firepower left – we estimate excess savings as £146bn – and rising confidence may spur business investment, which has lagged so far, to recover too (Chart 20). We have lowered our 2021 GDP growth estimate, but only by 0.5pp, to 6.7%.

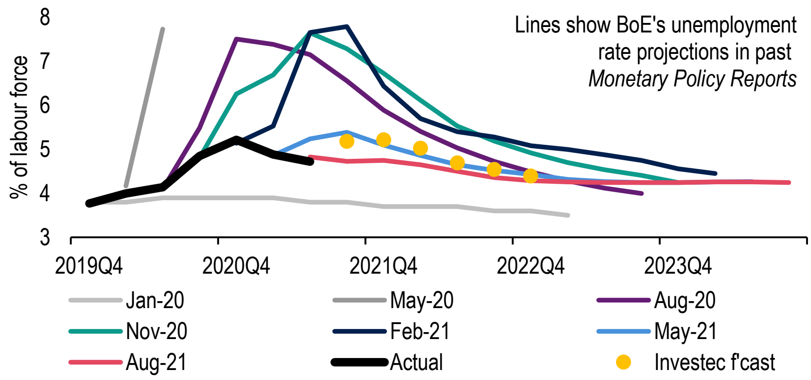
Chart 20: Unlike GDP, business investment is still far below its pre-pandemic level



Source: ONS, Macrobond and Investec

In its latest *Monetary Policy Report*, the Bank of England cut its unemployment projections: in its central case, it no longer expects the unemployment rate to rise after the furlough scheme ends by the end of Q3 (Chart 21). This is a marked shift relative to previous forecasts, which had consistently pointed to further rises in unemployment from their latest level, and which had turned out too pessimistic. Vacancies are now at record highs (953k), which we concur is a positive sign. But it would take only a small portion of those currently still on furlough to lose their jobs in the coming months to trigger a rise in the unemployment rate. We forecast a peak of 5.2%, followed by gradual declines, but uncertainty is high.

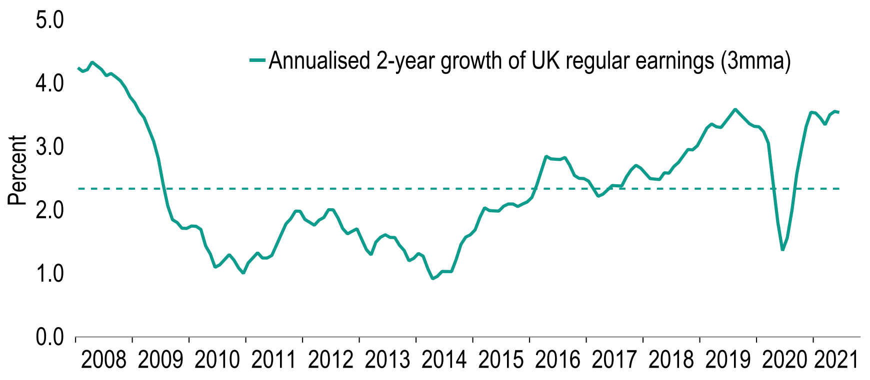
Chart 21: The Bank of England no longer expects the unemployment rate to rise post-furlough



Source: Bank of England and Investec

Just one MPC member (Michael Saunders) voted to cut the £895bn QE target at August's meeting, so there is now little to prevent this from being met, as planned, in December. The committee spelt out its intended tightening sequencing, stating it will raise the Bank rate to 0.5% before letting maturing gilts in its portfolio run off unreplaced. At 1.0%, the MPC will consider active gilt sales. The BoE still expects a temporary rise in CPI inflation, but now to a higher peak of 4.1% later this year. We see a similar path, but a lower peak, at a touch above 3%. This, coupled with our unemployment forecast, should lower the risk of surging wages. Indeed though headline earnings growth hit 8.8% (3m yoy) in June, it…

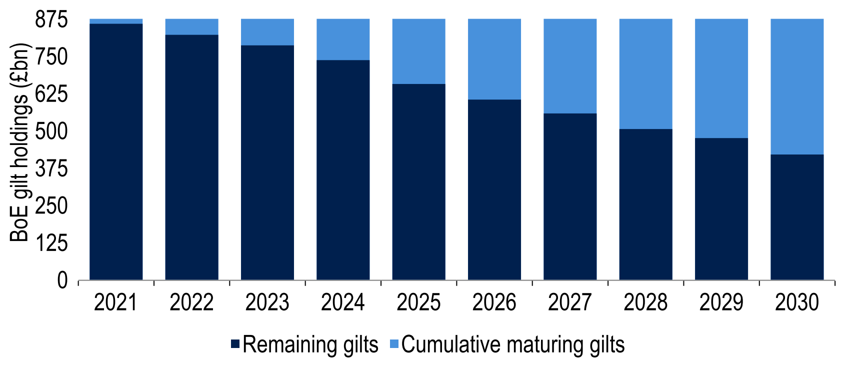
Chart 22: Despite elevated headline figures, UK underlying wage growth remains modest



Source: Macrobond

… largely reflects higher pay as workers have returned from furlough. A 2-year comparison (Chart 22) suggests underlying upward momentum is modest. As signalled two weeks ago, we see a 15bp hike in the Bank rate to 0.25% in Q2 next year, a rise to 0.50% in Q4 and to 1.0% by end-2023. The QE runoff strategy means gilt holdings will be allowed to decline automatically as they mature, implying a reduction of £35bn in 2023, £50bn in 2024 and £80bn in 2025. On top of that we are pencilling in a total of £20bn in direct sales over the latter two years. We note that the yield curve is not pricing in a Bank rate anywhere near 1.0% over the next five years, implying…

Chart 23: If the Bank didn't replace maturing gilts, its stock would halve by 2030

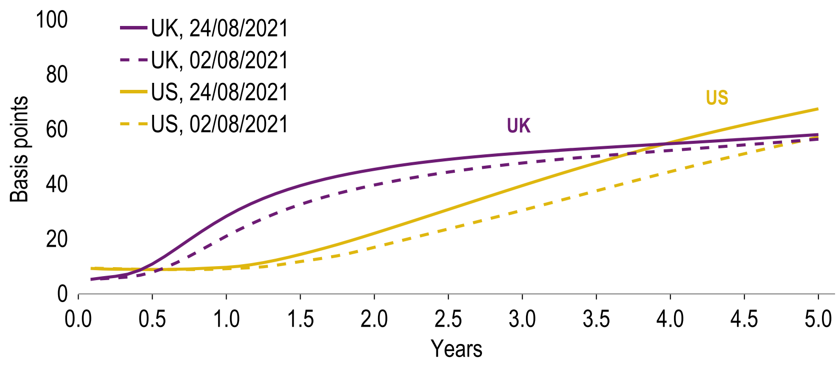


*2021 includes gilts that mature from 25/08/2021 onwards only

Source: Macrobond

… no direct QE sales over that period. But it has steepened, and by more than the US curve over the next 18 months (Chart 24). August so far has seen relatively little currency volatility, with limited response to recent drivers, such as Covid trends, market risk on/risk off moods and, indeed, interest rate differentials. We have maintained our existing profile for sterling with an end-2021 target of $1.42, from $1.37 now. Part of this reflects our relatively upbeat view of the euro (we see sterling at 86p against the single currency at the end of the year), but the three other factors mentioned above may also support GBP. Our end-2022 forecasts are still $1.53 and 82p.

Chart 24: UK and US forward curves have both risen, but have shaped differently



Source: Macrobond

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Global Forecasts

GDP Growth (%)

	Global	US	Japan	China	UK	EU19	Germany	France	Italy
2016	3.3	1.7	0.8	6.9	1.7	1.9	2.2	1.1	1.3
2017	3.8	2.3	1.7	6.9	1.7	2.6	2.6	2.3	1.7
2018	3.6	3.0	0.6	6.7	1.3	1.9	1.3	1.9	0.9
2019	2.8	2.2	0.3	5.8	1.4	1.3	0.6	1.5	0.3
2020	-3.3	-3.5	-4.8	2.3	-9.9	-6.6	-4.9	-8.2	-8.9
2021	5.9	6.2	2.7	8.1	6.7	5.2	3.4	6.6	5.7
2022	4.7	4.3	2.5	5.5	5.2	4.8	5.0	4.5	4.0

Source: IMF WEO, Macrobond, Investec forecasts

Key Official Interest rates (%, end quarter):

	US Fed funds	Eurozone refi rate	Eurozone deposit rate	UK Bank rate	Australia cash rate
Current	0.00-0.25	0.00	-0.50	0.10	0.10
2021					
Q1	0.00-0.25	0.00	-0.50	0.10	0.10
Q2	0.00-0.25	0.00	-0.50	0.10	0.10
Q3	0.00-0.25	0.00	-0.50	0.10	0.10
Q4	0.00-0.25	0.00	-0.50	0.10	0.10
2022					
Q1	0.00-0.25	0.00	-0.50	0.10	0.10
Q2	0.00-0.25	0.00	-0.50	0.25	0.10
Q3	0.00-0.25	0.00	-0.50	0.25	0.10
Q4	0.00-0.25	0.00	-0.50	0.50	0.10

Source: Macrobond, Investec

10-year government bond yields (%, end quarter):

	US	Germany	UK
Current	1.30	-0.45	0.57
2021			
Q2	1.49	-0.18	0.74
Q4	1.75	-0.25	0.75
2022			
Q2	2.00	-0.25	1.00
Q4	2.00	0.00	1.25

Source: Refinitiv, Investec

FX rates (end quarter/ annual averages)

		Current	2021				2022				2020	2021	2022
		25-Aug	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	average	average	average
Euro	€:$	1.175	1.18	1.19	1.20	1.22	1.23	1.23	1.26	1.26	1.14	1.20	1.24
Sterling	€:£	0.856	0.85	0.86	0.89	0.86	0.85	0.84	0.84	0.82	0.89	0.87	0.84
	(£:€)	1.168	1.17	1.16	1.13	1.16	1.17	1.19	1.19	1.21	1.13	1.15	1.18
	£:$	1.372	1.38	1.38	1.35	1.42	1.44	1.46	1.50	1.53	1.28	1.38	1.47
Yen	$	109.8	111	111	108	106	104	104	104	104	107	109	104
	€	129.0	130	132	130	129	128	128	131	131	122	130	129
	£	150.7	152	153	146	151	150	152	156	159	137	149	153
Aussie Dollar	$	0.726	0.76	0.75	0.77	0.80	0.80	0.80	0.80	0.80	0.69	0.77	0.80
	€:AUD	1.618	1.54	1.58	1.56	1.53	1.54	1.54	1.58	1.58	1.66	1.56	1.55
	¥	79.71	84.2	83.3	83.2	84.8	83.2	83.2	83.2	83.2	73.6	83.2	83.4
	£:AUD	1.891	1.81	1.84	1.75	1.78	1.80	1.83	1.88	1.91	1.86	1.79	1.84
Swiss Franc	€	1.073	1.11	1.10	1.10	1.12	1.12	1.14	1.14	1.16	1.07	1.10	1.14
	$	0.914	0.94	0.93	0.92	0.92	0.91	0.93	0.90	0.92	0.94	0.92	0.92
	£	1.254	1.30	1.28	1.24	1.30	1.31	1.35	1.36	1.41	1.20	1.27	1.34

Source: Refinitiv, Investec