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The Coming Global Growth Revival

Our weekly view on Asset Allocation.

8 March 2021

The Stage is Set

We believe a combination of pent up consumer demand, fiscal stimulus and accommodative monetary policy set the stage for a sharp global economic recovery in 2021.

The global vaccine roll-out currently underway should dramatically improve health outcomes and allow a significant normalisation in consumer behaviour as we move through the year. Massive fiscal stimulus will provide an additional impulse to lift global GDP growth to its fastest rate in at least 40 years.

US to lead the growth revival in 2021

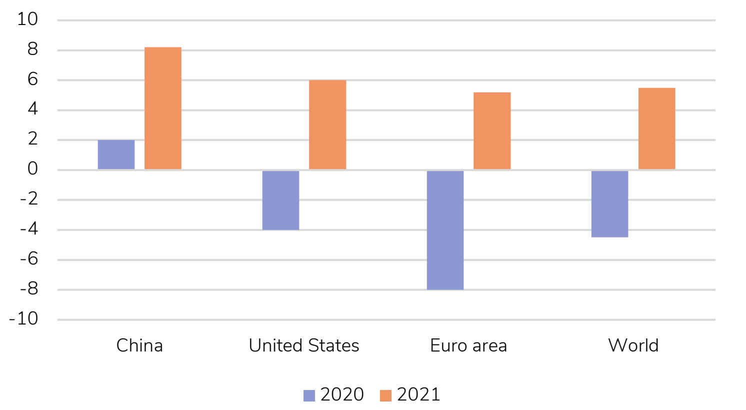
After a 4% contraction in 2020, US GDP growth will likely comfortably exceed 5% in 2021. In total US fiscal stimulus is expected to rise from a 15% of GDP in 2020 to 20% in 2021. Thus the record "emergency spend" of CY20 will actually step up again in CY21 at a time when vaccine coverage should allow economic behaviours to normalise.

Here comes the US consumer (again)

The US consumer will be at the epicentre of this recovery. Under President Biden's imminent US$ 1.9 trillion (around 10% of GDP) relief package, lower-income households will benefit from very large fiscal transfers totalling nearly $1tn, including stimulus cheques and supplementary unemployment benefits. As the influence of COVID-19 recedes, higher-income families will increasingly be able to spend some of the almost US$2tn accumulated in excess savings, which has been built up from reduced consumer services spending and previous fiscal support packages. This drawdown in the household savings rate will create a powerful tailwind for consumer spending in 2021.

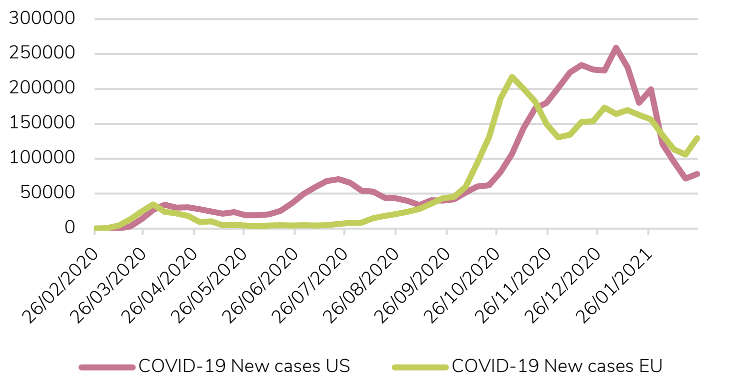
The impact of stronger consumer demand in 2021 (particularly for services) should lead to a renewed upswing in US employment growth. We anticipate the unemployment rate will fall back toward 5% in Q4, with the economy adding around 6-7 million jobs in 2021.

Exhibit 1: Global growth is poised to rebound strongly in 2021



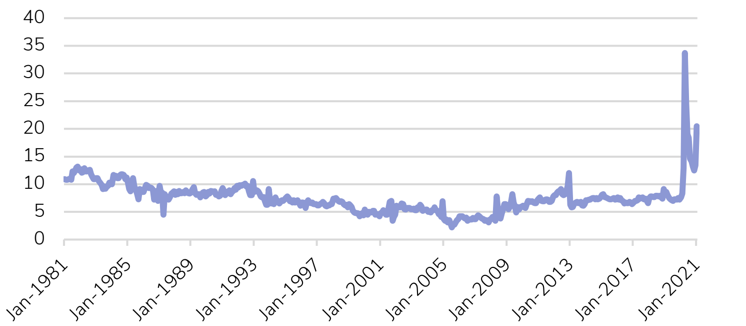
Source: Refinitiv, Wilsons

Exhibit 2: Covid daily case rates US vs EU



Source: Refinitiv, Wilsons

Exhibit 3: Large pent up consumer demand via the huge rise in the US savings ratio



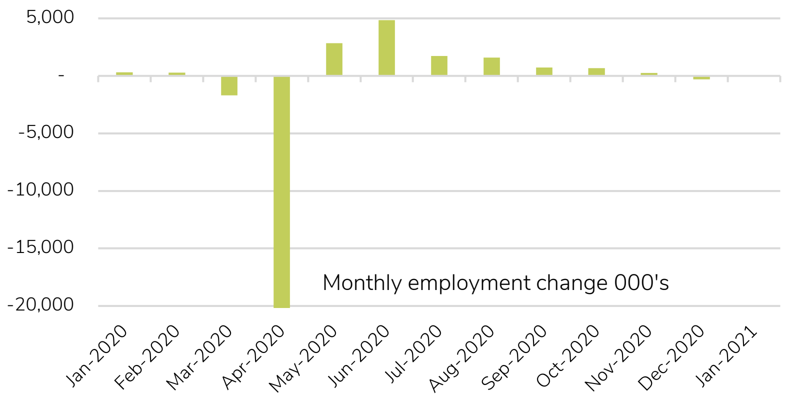
Source: Refinitiv, Wilsons

Depressed year-on-year baseline comparisons will lead to higher inflation in Q2; however, both the Fed and the market should look through this short-term blip. Inflation should moderate again in the second half of this year before pushing higher in 2022. This should allow the US bond market to hang together though there is risk that the sheer pace of the economic growth acceleration will worry the bond market even if inflation remains in check.

But wait there's more

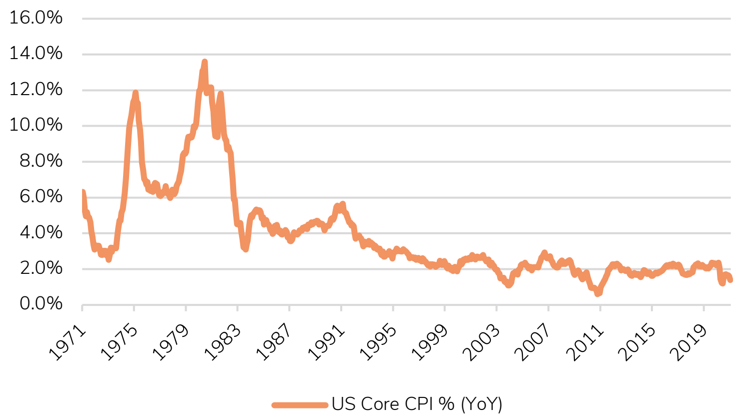
Policy stimulus risks are likely to be tilted to the upside for some time. Once Congress passes Biden's US$1.9 trillion relief package (likely mid-March), policymakers' attention will shift to Biden's proposed "Build Back Better" plan. Democrats can use the budget reconciliation process (as they have for the huge package currently in the Senate), which requires only 50 votes in the Senate, twice this year. This plan is likely to focus on a mix of infrastructure spending, and climate change initiatives that would be paid for with an increasing individual income taxes on high-income earners and a partial reversal of Trump's large corporate tax rate cut. US$3 trillion for infrastructure and US$2 trillion for energy transition/climate change have been muted. While it will be spread across multiple years, the pipeline of fiscal stimulus is quite staggering.

Exhibit 4: The US employment recovery has stalled but should re-accelerate



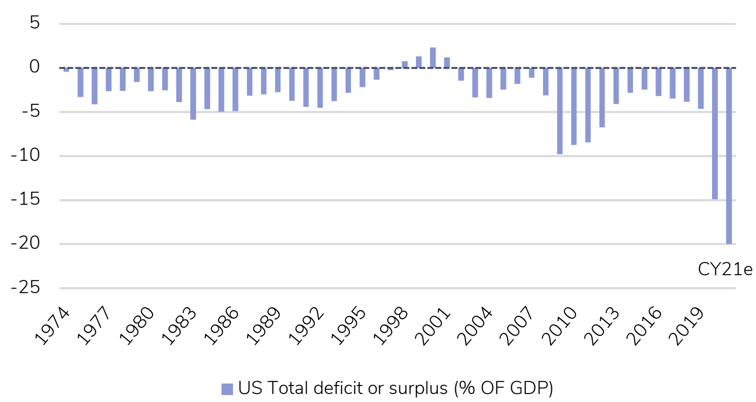
Source: Refinitiv, Wilsons

Exhibit 5: US CPI. 30 years of low and stable



Source: Refinitiv, Wilsons

Exhibit 6: US Budget deficit. Big gets bigger



Source: Refinitiv, Wilsons

China to also grow strongly but watch for signs of credit tightening

The world's second-largest economy China, should also experience a strong recovery in 2021, with slower but still impressive growth in subsequent years. We expect China's real GDP growth to rebound to around 8.% in 2021 after "only" 2% growth in 2020. Exports and domestic consumption will lead the rebound.

The annual National People's Congress (NPC) meeting begins on 5th March, which will unveil China's key economic targets and policies for 2021 and beyond. With growth set to recover strongly this year, we expect the NPC to shift focus towards risk and leverage control, targeting a smaller fiscal deficit, a more prudent monetary policy stance and slower credit growth. The NPC will also outline a push for further reform and highlight technology innovation and greener development as future goals.

With Covid-19 largely under control, we expect China to ease mobility restrictions further, and economic activities should resume gathering momentum in Q2. We expect the government to target total credit growth that is "broadly in line with nominal GDP growth", allowing China's macro leverage to stabilise this year following a sharp rise in 2020. Property developers, fintech companies, and banks will likely face stricter financial regulations. Credit to finance infrastructure investment should decelerate due to fiscal policy normalisation and Beijing's concern about local government debt. That said, we think that policymaking will be flexible to avoid excessive policy tightening. The market could worry periodically about credit tightening though we don't expect credit issued to the corporate sector to slow sharply. Household loan growth will likely slow somewhat this year, but the pace should remain sufficient to support a revival in consumption.

Eurozone. Some light at the end of a long tunnel

The Eurozone experienced a very deep contraction in Q2-2020. GDP fell a massive -6.8% in 2020 and has struggled to regain its footing in recent months, with COVID-19 lockdowns still hampering activity. While growth is still tepid, lockdown measures are expected to ease markedly during Q2-21, and the economy should be much less affected by Covid-19, allowing a strong H2-2021 pick-up. We expect a very solid bounce to 5.0% growth in 2021 and 5.0% again in 2022, which is very strong by European standards.

Fiscal and monetary policy support will remain strong in 2021, albeit not at US levels of stimulus. The Eurozone fiscal deficit should moderate from around 8.0% of GDP in 2020 to around 6.0% in 2021. We expect a cautious degree of normalisation in 2022 with recognition of the excessive tightening that occurred in the years post the GFC.

Core inflation picked up to 1.4% in January, which was the highest in five years. However, we expect full year inflation to stay benign at around 1.5%.

The global economic revival and the great bond/equity balancing act

In summary, global (and domestic) growth should pick up significantly this year due to vaccine effectiveness, pent up consumer demand and significant fiscal stimulus. Huge policy stimulus in the US will see the US consumer lead the way. Better global growth will drive corporate earnings significantly higher which should support equity markets.

The challenge for equity markets will be the rising long term interest rates which are already causing some periodic angst, particularly in the long duration tech sector. Inflation should pick up this year but not dramatically, and Central banks will continue to try and support the recovery with ongoing QE and zero cash rates. We expect more volatility and periodic rotation from tech/growth to cyclicals/value. On balance, we think equities should be higher by year end, but we are likely entering a more volatile phase for markets.

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Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures

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