Monthly Macro Insights

June 2021

Rothschild & Co
Asset Management

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Despite renewed – although less frequent – virus outbreaks throughout the world, prospects for a lasting global recovery continue to improve. The manufacturing sector is expanding rapidly, merchandise trade is rebounding strongly as borders gradually reopen, and travel is slowly resuming. Meanwhile, US interest rates have stabilised for the past three months; a welcome – albeit temporary? – development that supported financial markets.

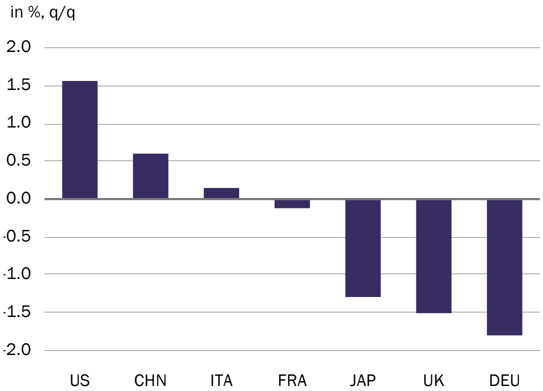
Regional divergences widen…

After a significant downshift in Q1 2021, global growth is expected to accelerate, thanks to the deployment of effective vaccines and pent up demand being unleashed with the gradual reopening of economies. Business investment remains a bright spot, although early releases of April retail sales in advanced economies showed sharp drops in Germany, France, Japan and the US, suggesting a durable rebound in household consumption has been once again postponed.

However, while investors' optimism remains elevated, imbalances are intensifying.

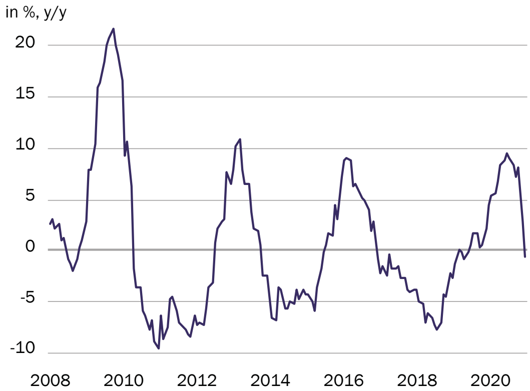
The economic upturn since mid-2020 has been uneven and the US has retaken the growth leadership position from China. Indeed, the US suffered little economic impact from the second wave of the pandemic, and the fiscal policy induced stimulus has been amplified by an aggressive vaccination program, as a result of which US GDP soared 1.6% q/q in Q1 2021[1]. By contrast, China's remarkable recovery last year faded faster than anticipated. While the export sector remains strong, activity data for April suggest that Chinese domestic demand has weakened, weighed down by a sharp reversal of credit impulse.

World - Q1 2021 GDP



Source: Macrobond, Rothschild & Co Asset Management Europe, June 2021.

China - Credit impulse



Source: Bloomberg, Rothschild & Co Asset Management Europe, June 2021.

(1) Source: US BEA, June 2021.

Considering the importance of China's trade ties, its waning momentum represents a headwind for most emerging countries (EM). Business confidence in Asia-ex China fell markedly in May, both in the manufacturing and services sectors. What's more, several EMs have faced challenges in controlling the pandemic amid slow vaccination programmes. Higher caseloads are forcing governments to adopt stricter containment measures and mobility has collapsed in Turkey and India, for example, and fallen sharply in a number of other Asian economies, including Thailand and Singapore. That said, declines in mobility are now having a smaller adverse impact on activity than in the early stages of the pandemic.

The revival of global trade should benefit many EMs, but tourism-dependent economies face a slow recovery, and household incomes will be adversely affected by higher energy and food costs, as well as currency depreciations.

... as supply struggles to keep up

The pandemic has constrained the normal elasticity of supply meeting demand. Through the second half of last year, shortages in industry extended delivery times slowed the rebound in stock building, pushing up goods prices. Furthermore, shipping costs have soared due to the combination of booming demand for consumer durables and supply-side bottlenecks created by sanitary restrictions in ports and terminals. Business surveys show signs of skills shortages for some small businesses, which also could increase input cost pressures.

While inflation remains contained in regions like Japan and the Eurozone, aspects of inflation-related data are testing investors' trust in central banks' pledge to price stability. In the US, the price index for personal consumption expenditures (PCE) jumped 0.6% m/m in April, or 0.7%[2] excluding food and energy, one of the largest monthly gain since early 1980's. Part of that increase was due to surges in prices for used vehicles, airfares, and lodging, suggesting the rapid rate of inflation in April is related to supply chain issues in the auto sector and the strong recovery in travel and tourism associated with virus-related developments.

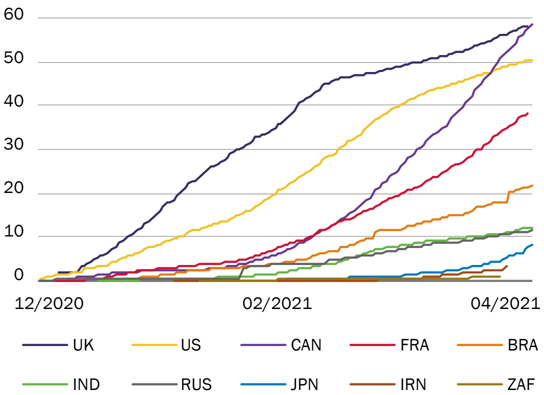
The forces currently pushing prices higher are expected to fade later this year, as ample unused global production capacity will be activated by reopenings in the coming months. Alongside an expected rotation in global demand toward the services sector, goods price pressures are thus likely to abate. In addition, labour markets still hold a lot of slack, restraining wage growth.

Persistently high inflation could jeopardise the outlook

Correspondingly, rapid price increases could weaken global demand and hurt the recovery in a negative feedback loop. Part of the actual increase is not endogenous to the business cycle, but rather represents a negative exogenous shock to firms' and households' purchasing power. For instance, in the commodity space, higher oil prices are, in part, due to OPEC's decision not to increase its production,

World - Vaccination rate

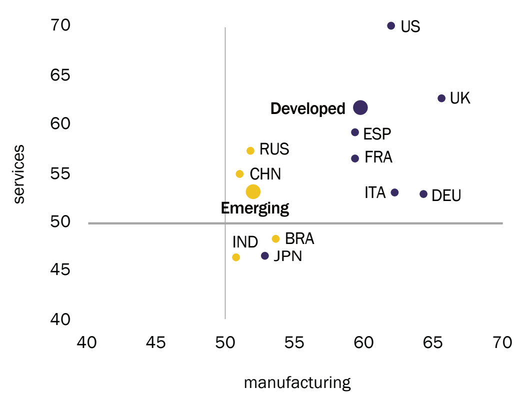
in % of population that has received at least one dose



Source: Macrobond, Rothschild & Co Asset Management Europe, June 2021.

World - Markit confidence index

May 2021



Source: Macrobond, Rothschild & Co Asset Management Europe, June 2021.

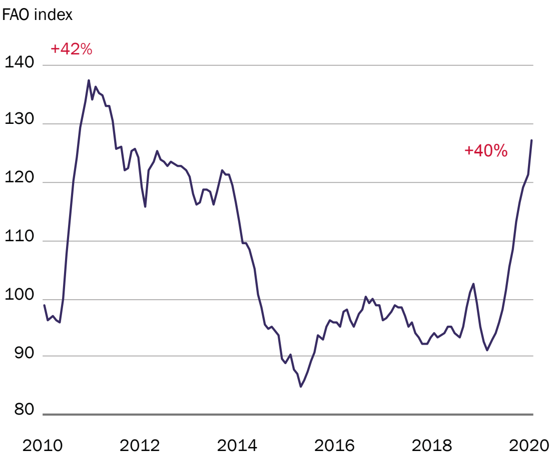
(2) Source: US BEA, June 2021.

which is clouded by the US-Iran nuclear talks. China's desire to build up inventories has also distorted the balance between supply and demand for several base metals and basic food items, while bad weather and poor harvests are also at play.

Transitory or sticky inflation, that is the question for central banks. What is most concerning is the risk that financial markets decide not to look through price increases, pushing interest rates and volatility higher. For now, financial stress in the business sector has been contained due to the ability of firms to raise cash quickly, while public sector support through loans, credit guarantees and tax deferrals, as well as temporary changes to insolvency regimes, has morphed into a general slowdown in bankruptcies. Yet, the trajectory of inflation remains subject to debate and continues to weigh on the outlook through several channels, especially financial stability. ■

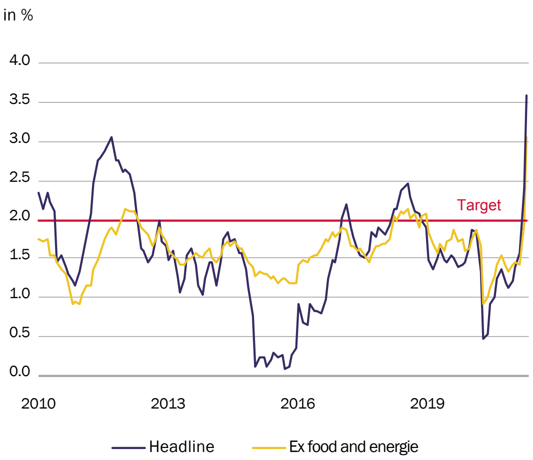
Completed writing on 3 June 2021

World - Food prices



Source: Bloomberg, Rothschild & Co Asset Management Europe, June 2021.

US - Inflation rate PCE



Source: Macrobond, Rothschild & Co Asset Management Europe, June 2021.

Performance of the indices and interest rate levels

	Price as of 31/05/2021	1 month % change	2021 % change
Equity markets			
CAC 40	6 447	2.8%	16.1%
Euro Stoxx 50	4 039	1.6%	13.7%
S&P 500	4 204	0.5%	11.9%
Nikkei 225	28 860	0.2%	5.2%
Currencies			
EUR/USD	1.22	1.7%	0.1%
EUR/JPY	133.97	2.0%	6.2%

		Price as of 31/05/2021	1 month bp(1)	2021 bp(1)
Interest rates				
3 months	Eurozone	-0.63%	0	14
3 months	United States	0.00%	0	-6
10 years	Eurozone	-0.19%	2	38
10 years	United States	1.59%	-3	68

(1) Basis point.
Source: Bloomberg, data as of 31/05/2021. Performances in local currency.
Past performance is not a reliable indicator of future performance and is not constant over time.

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