Monthly Macro Insights

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Rothschild & Co
Asset Management

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As expected, global growth downshifted sharply in Q1 2021. However, business confidence upturn accelerated in April amid optimism that vaccination programmes will allow governments to lift restrictions and spur pent up demand and economic activity. Looking ahead, new vaccine-resistant Covid-19 variants, combined with the spectre of inflation, continue to weigh on the outlook.

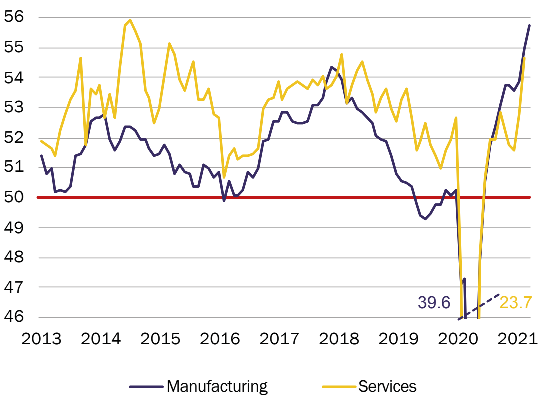
Strong divergence among countries

Over the past month, Covid-19 outbreaks have once again worsened, forcing several governments to ratchet up lockdown measures. Although the economic impact has been less pronounced than originally feared thanks to targeted, but effective, restrictions – as consumers and businesses adapted more efficiently compared to 2020 – the new waves of contagions have nonetheless weighed on economic activity.

In the eurozone, the economy remained in recession as GDP fell -0.6% q/q in Q1 2021 after a similar drop at the end of last year, confirming that the off-and-on coronavirus restrictions has hurt economic activity, albeit with large discrepancies across countries. Portugal (-3.3%) and Germany (-1.7%) were particularly badly hit, whereas Belgium (0.6%) and France (0.4%)[1] outperformed. That said, the positive monthly surveys for April – Markit index and Economic Sentiment Indicator – suggest that Q2 looks set to be the start of a more meaningful rebound, and market participants even anticipate growth in the eurozone will outstrip the US' in H2 2021.

After a strong H2 2020, Chinese GDP grew a mere 0.6% q/q in Q1[2] – the weakest since the Great Financial Crisis outside the sharp drop in early 2020 – following renewed coronavirus caution around Chinese New Year and less generous fiscal and monetary policy. Indeed, Prime Minister Li Keqiang presented in March the government's

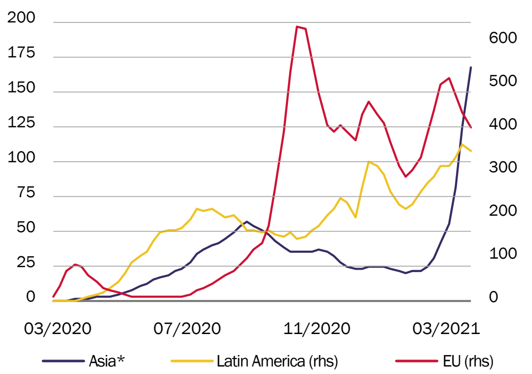
World - Business confidence index



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

World - Covid-19 new cases

per 100 000 inhabitants, 14 days



**ex China*

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

(1) Source : Eurostat, 31/03/2021.
(2) Source : National Bureau of Statistics of China, 31/03/2021.

2021 work report to the National People's Congress, which included the relatively unambitious goal of growth "above 6%" – while the IMF is forecasting 8.3% – thus confirming the transition toward more modest GDP target in order to contain financial stability risks.

Considering the importance of China's trade ties, its waning momentum represents a headwind for most emerging countries (EM), especially since Covid-19 new cases are reaching record highs in many of them, placing severe strain on their health-care systems. And it's not just India. Nations ranging from Laos to Thailand in Southeast Asia, and those bordering India such as Bhutan and Nepal, have reported significant surges in infections in the past few weeks.

In Latin America, the situation also remains critical. According to some health experts, variants might require a new vaccine and a booster for those already vaccinated, which would once again delay the control of the pandemic. The World Health Organization has also delivered a stark warning of the risk governments in advanced economies are taking by failing to ensure all countries have sufficient access to vaccines.

Yet, pandemic dynamics in the US and the UK have allowed investors to remain optimistic, as both countries appear to be in control of the virus amid a rapid pace of vaccinations. Combined with a significant fiscal stimulus, the US GDP jumped 1.6% q/q in Q1 – or 6.4% annualised[3] – thanks to a gradual normalisation of economic activity. In fact, the US economy is opening up a sizable growth differential with the rest of the world.

The debate about price pressures is inflating

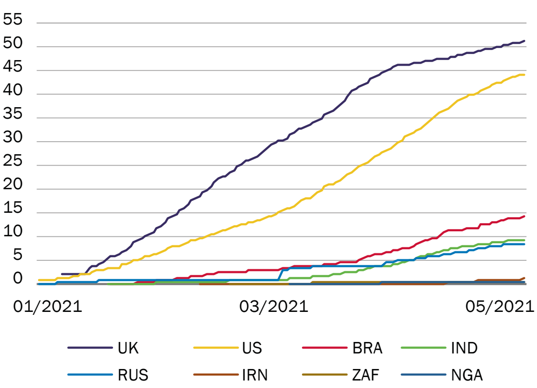
The positive developments in the US might have a significant impact on business and consumer confidence abroad, and this positive feedback loop could spur consumption and investment globally. However, estimating the impact robust growth in the US spilling over to other regions is not straightforward. For instance, long-term interest rates in the US rose markedly since last summer's unprecedented low. While they have stabilised recently, the contagion to interest rates in other countries could prove problematic, especially if the upturn were to return.

The Fed plans to keep its key rate near 0% and maintain monthly asset purchases worth USD120bn until it sees substantial further progress towards full employment and its 2% flexible inflation target. Yet, according to the latest IMF projections, advanced and emerging economies should expect considerable slack in 2022-2023, with the notable exception of Canada and the US.

At its April meeting, in a move that surprised investors, the Bank of Canada (BoC) upgraded its forecasts for economic growth and announced their decision to taper bond purchases, becoming the first major central bank to cut back on pandemic-era stimulus programmes. Furthermore, the BoC changed its guidance to show it could start raising its benchmark interest rate in late 2022 – vs early 2023, as previously indicated.

World - Vaccination rate

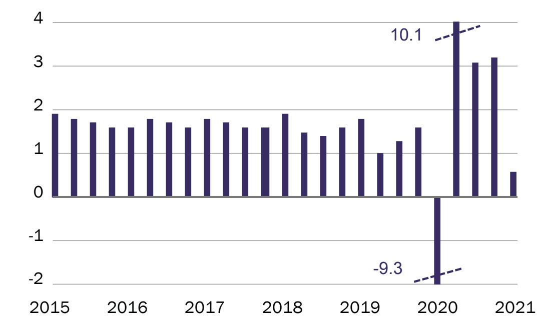
In % of population that has received at least one dose



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

China - GDP

in %



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

(3) Source : Bureau of Economic Analysis, 31/03/2021.

Trying to link the Fed and BoC on policy rate normalisation might be misguided for two factors. First, the Fed's inflation overshooting framework provides powerful guidance, committing it to a low-for-long policy until inflation moves sustainably above its target.
Second, actual inflation outturns have been lower in the US than in Canada.

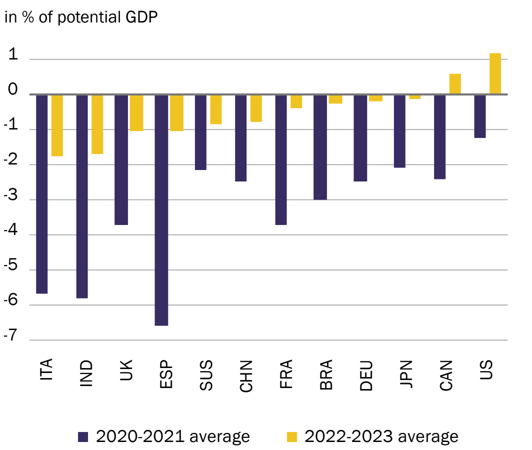
Still, the latest ISM business survey[(4)] reveals that the US manufacturing sector continues to be weighed down by logistical challenges, including material shortages, and employment and transportation bottlenecks, making it difficult for firms to meet higher demand. These dynamics are raising inflationary pressures, whereas the prices paid sub-index jumped to 89.6, the highest level since 1974 – apart from June/July 2008 and July 1979. The key question for investors is whether these bottlenecks will be resolved once pandemic-related restrictions ease and economic activity returns to normal.

For now, the Fed is unlikely to modify its forward guidance as the normalisation of the labour market is far from complete. However, some members called for beginning the conversation about reducing central bank support for the economy, warning of imbalances in financial markets and arguing the economy is healing faster than expected.

What's more, commodity prices have rallied sharply in the past weeks, namely in the agricultural segment. Combined with a mix of currency depreciation and coronavirus disruptions, food inflation is soaring in most EM, as a UN gauge of food costs rose in March to the highest since 2014. Rising food prices have contributed to social unrest in the past as this category accounts for more than 25% of EM CPI baskets, compared to around 10% in advanced economies. For EM central banks, the temptation may be to let inflation rise and keep monetary conditions loose to support growth, yet at a cost of unanchored inflation expectations. Overall, although improvement in the global goods trade continues to be a bright spot for EM, new challenges are making the outlook somewhat murkier. ■

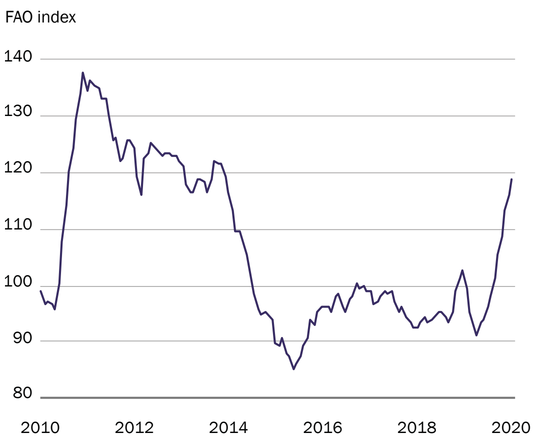
Completed writing on 5 May 2021

World - Output gap



Source: IMF, Rothschild & Co Asset Management Europe, May 2021.

World - Food prices



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

(4) Purchasing Managers' Index, an indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it indicates an expansion of activity, below 50, a contraction.

Performance of the indices and interest rate levels

	Price as of 30/04/2021	1 month % change	2021 % change
Equity markets			
CAC 40	6 269	3.3%	12.9%
Euro Stoxx 50	3 975	1.4%	11.9%
S&P 500	4 181	5.2%	11.3%
Nikkei 225	28 813	-1.3%	5.0%
Currencies			
EUR/USD	1.20	2.5%	-1.6%
EUR/JPY	131.40	1.2%	4.1%

		Price as of 30/04/2021	1 month bp(1)	2021 bp
Interest rates				
3 M	Eurozone	-0.63%	0	14
	United States	0.00%	-1	-6
10 Y	Eurozone	-0.20%	9	37
	United States	1.63%	-11	71

(1) Basis point.
Source: Bloomberg, data as of 30/04/2021. Performances in local currency.
Past performance is not a reliable indicator of future performance and is not constant over time.

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As the specialised asset management division of the Rothschild & Co group, we offer personalised asset management services to a broad client base of institutional investors, financial intermediaries and distributors. Our development is focused on a range of open-ended funds, marketed under four strong brands: Conviction, Valor, Thematic and 4Change, and leveraging our long-term expertise in active management with conviction as well as in delegated management. Based in Paris and established in 10 European countries, we manage more than 21 billion euros and employ nearly 170 people. More information at: www.am.eu.rothschildandco.com

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