Macro update

27 May 2021

Steven Bell
Chief Economist

Contact us

bmogam.com

Follow us on LinkedIn

Economic recovery and inflation: the challenge for markets

Vaccines versus the Indian variant

Global growth and reflation

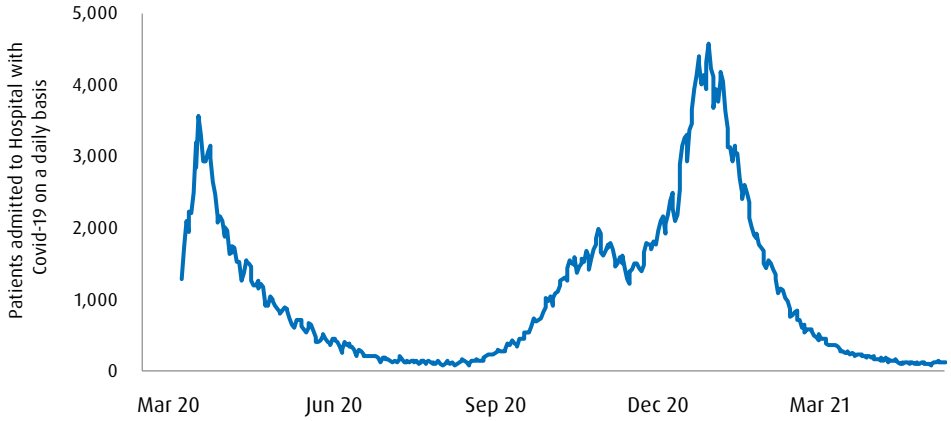
What does this all this mean for markets?

The UK's response to the virus was going oh-so-well until the sudden arrival of the Indian variant. Stimulus measures have been huge, but how will the effect of Biden's infrastructure plans on economic growth differ from the unemployment packages? Will markets focus on growth: good for earnings and risk assets – or will it be all about inflation: bad for everything?

Continued

How dangerous is the Indian variant?

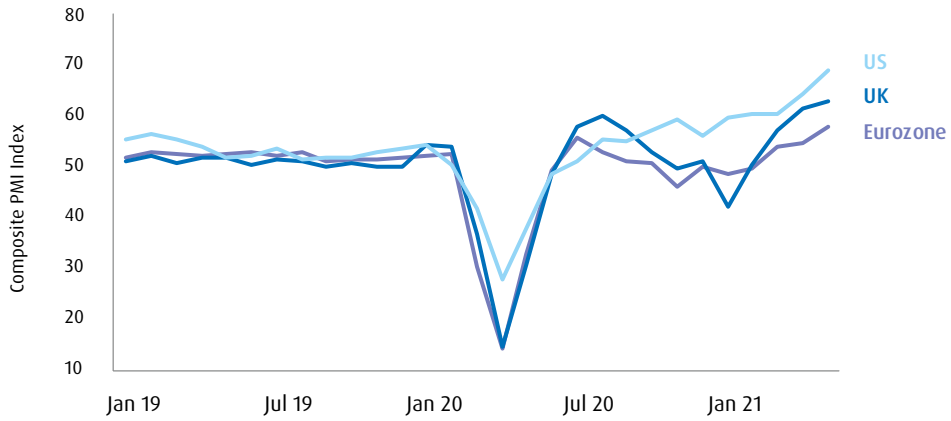
UK hospitalisations



Source: BMO Global Asset Management and UK Government as at 19 May 2021

- In January 2021, the total number of people in hospital in the UK with Covid-19 was nearly 40,000. The current number is less than 1,000 – a fall of 98%.
- The SAGE report produced for the government on the Indian variant paints a very worrying picture; with a 'plausible adverse scenario' (not even the worst case assumption) predicting that hospitalisations could go back up to match the peak in January 2021 and put the NHS at breaking point. Yet on closer inspection, the plausible adverse scenario is based on very pessimistic assumptions.
- Action is being taken to mitigate the risks from the Indian variant, such as bringing forward second vaccine doses for those in the worst affected areas, and although the government are making cautious statements, we still think it is likely that the further easing planned for 21 June will still go ahead. The easing that has already taken place is starting to feed through into economic data.

PMI numbers surge, with Europe beginning to catch up



Source: BMO Global Asset Management and Bloomberg as at 20 May 2021

- The Purchasing Managers' Indices (PMIs) for overall economic activity first took off in the US, followed by the UK, and now Europe is beginning to catch up.
- The US has been boosted by the cumulative effect of successive bouts of huge fiscal stimulus.
- The vaccine roll-outs in Europe have been way behind the US and UK, but they are finally picking up pace and this is leading to restrictions being lifted, economies opening up and a boost in economic activity. If the Indian variant is kept under control, then the Europe PMIs should continue to follow the US and UK.

Global growth and reflation

Economic growth in the US has been supported by Biden's spending plans

Huge infrastructure bill, spread over several years

$447 bn on transport infrastructure

$400 bn on elderly & disability care

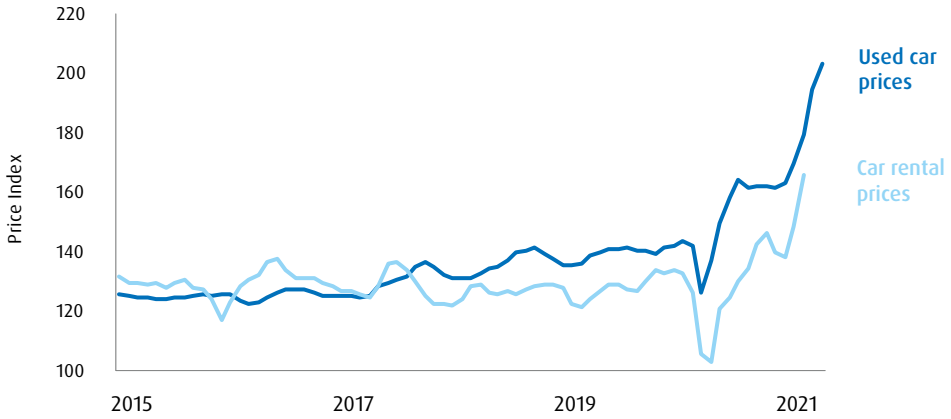
$380 bn on electric vehicles and green/affordable homes

$380 bn on digitisation

$657 bn on water, schools, job training, manufacturing

- The stimulus handouts paid to US workers over the course of the pandemic have been accumulating as 'Covid piggy banks' and mean that US consumers have built up huge spending powers.
- Another factor is Biden's enormous infrastructure programme – a huge mountain of spending. But Infrastructure takes time to get going and the spend is back-loaded, with tax rises coming ahead of the bulk of the programme.
- So fiscal policy moves from a massive net stimulus today, to a mild drag by year end. And those tax rises do not seem to be factored into analysts' forecasts of earnings.

Inflation – car prices soar



Source: BMO Global Asset Management and Bloomberg as at 23 May 2021

- We can see inflation in used car prices, which are being bid up, in part because auto companies can't keep up with demand as there is a shortage of semiconductors. And rental companies can't get new cars, so they're buying up the nearly new models, and pushing these prices up too.
- So, inflationary pressures are rising, and financial markets have noticed these pressures, but the US Federal Reserve appears not to be worried. This is because they see the rises as 'bottleneck' pressures – which are temporary.

What does this all mean for markets?

Economic momentum looks likely to peak over the summer as pent up demand is released, Covid piggy banks are spent and fiscal policy turns contractionary. The stream of good news on the vaccines, the economy and corporate earnings is likely to continue over the summer and maintain the equity rally.

But we could be in for a volatile autumn, as inflation worries could get worse before they get better. Particularly if the US Federal Reserve gets closer to tapering its QE programme, and markets start to wonder if the Fed could raise rates next year.

The prospect of the reduction in central bank bond buying means yields will be headed higher. All in all, risk assets look set to outperform on a three-month horizon as bonds sell off.

Macro update – **Webinar**

Watch the full replay of the Webinar, including a Q&A section.

Click here

Key risk

The value of investments and any income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested.

Views and opinions expressed by individual authors do not necessarily represent those of BMO Global Asset Management.

BMO Global Asset Management