



Quarterly Macroeconomic Outlook Update

April 22, 2021

Global Macroeconomy: What Changed in Q1?

- **Expectations for Global Growth Improved Markedly in Q1**
 - Now global GDP is forecast to expand in 6%-7% range this year
 - Roughly double the long-term average and...
 - Up 0.5%- point from January
- **Factors Underpinning Increasing Optimism Include:**
 - Additional extraordinary stimulus, particularly in US
 - Improving prospects for vaccine supplies and global vaccinations
 - Accumulated “extra” savings and pent-up demand
 - Limited scarring effects from relatively brief pandemic recession
- **Transitory and Regional Differences Due to Virus and Policy Divergence**
 - Renewed lockdowns in UK and Europe in Q1
 - Noteworthy changes in composition of global fiscal stimulus taking place
 - US is increasing stimulus significantly, while China is starting to taper

Global Cyclical Outlook (2021 & 2022)

Global Economy in Initial Stage of Robust Cyclical Recovery

- Fiscal thrust no longer expected to decelerate significantly in 2021
 - Key factor underpinning improving global outlook
- Central bankers appear committed to maintaining policy rates near zero
- Still considerable slack in global economy
- Virus setbacks appear to be transitory/much of world’s population expected to be vaccinated by yearend
- Global growth expected to be above trend in ‘22 but ...
 - Some deceleration of this year’s unsustainable pace expected

	Expected Real GDP Growth		
	Global	DMs	EMs
2020	-3.3	-5.0	-1.9 ¹
2021	6.0 6.5	5.0 5.6	6.8 7.2
2022	4.5	4.0	5.0

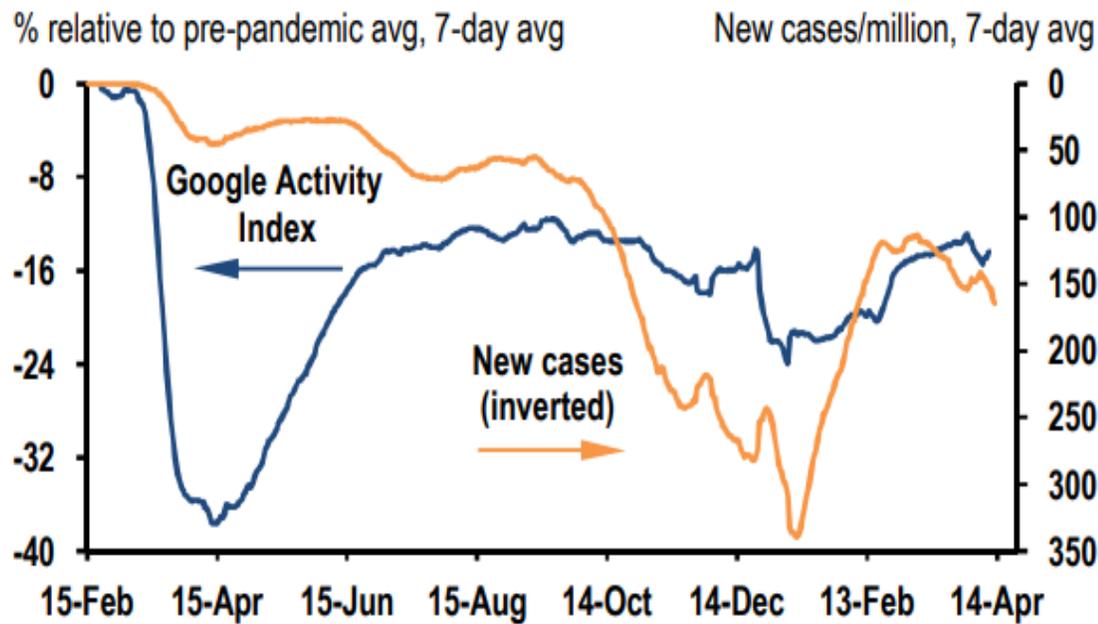
1. China responsible for relatively strong performance in 2020. EM ex China -4.5% in '20 and estimated at 5.7% for '21 and 4.5% for 2022

Macro Backdrop: Current Activity

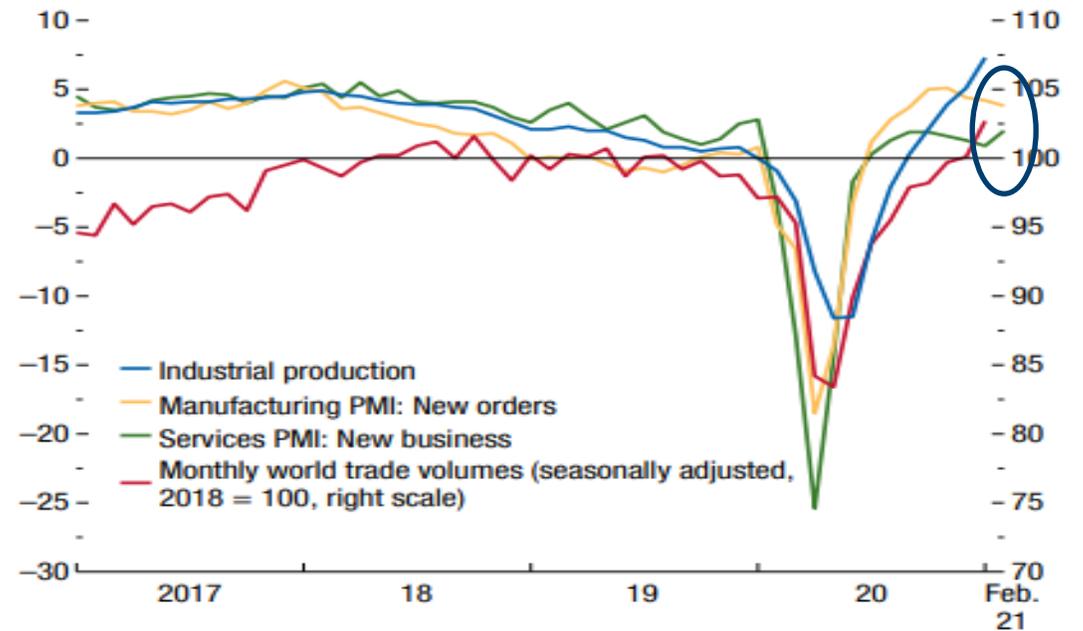
- Global mobility currently near post-pandemic highs
- Lockdowns more targeted than year ago and activity, in turn, is less responsive to latest uptick in new virus cases

- High frequency indicators suggest that manufacturing and trade are back to or above pre-pandemic levels
- But there is still some way to go in service sector

Global Activity & New Covid-19 Cases



Global Manufacturing, Trade & Service Sectors



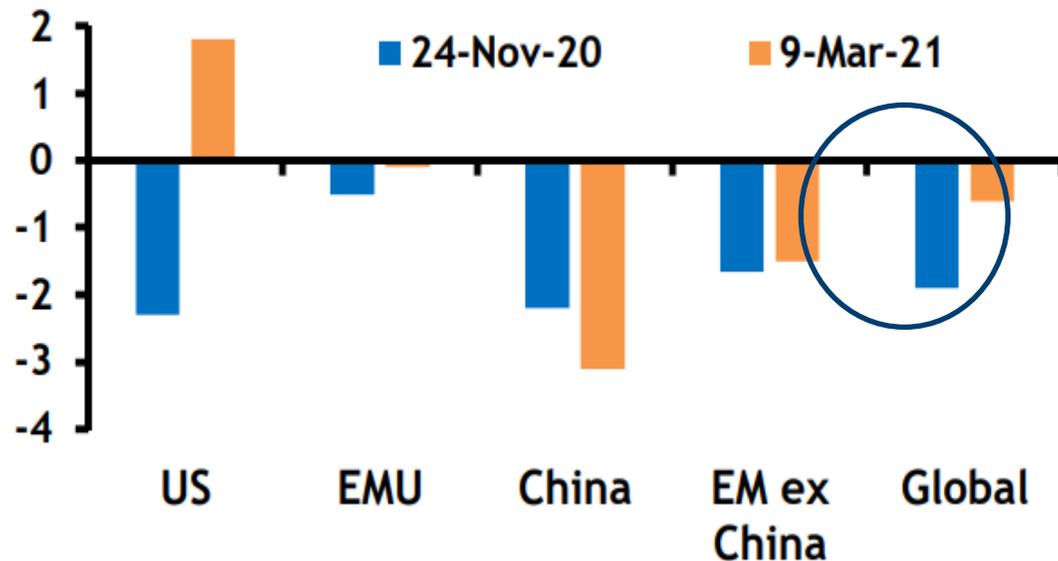
Source: Google, JPM, Haver Analytics, Markit, IMF

Macro Backdrop: Changes in Fiscal Policy & Accumulated Excess Saving

- Global fiscal policy has shifted from a significant headwind (equivalent to ~2% of GDP) in late-2020 to a relatively minor restraint (~0.25%)
- Change largely due to marked increase in US fiscal trust and increased fiscal restraint
- Combination of generous- government income support programs to protect consumers and...
- Curtailed spending during the pandemic have resulted in unprecedented excess saving in major DMs

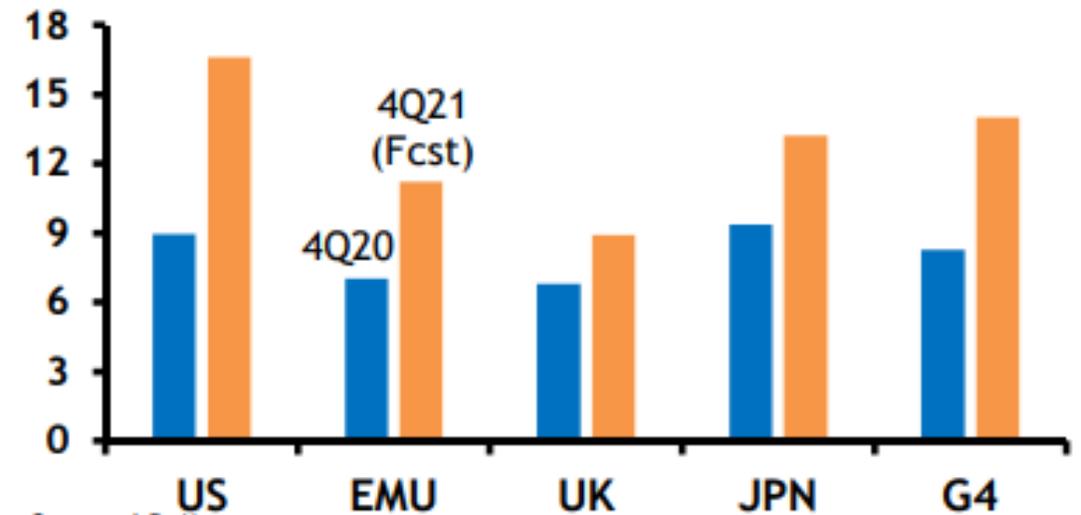
Global 2021 Fiscal Thrust

%pt impact on real GDP growth, by forecast date



G4 Excess Household Saving

% of household income, actual cumulative saving since 4Q19 less 2019 pace



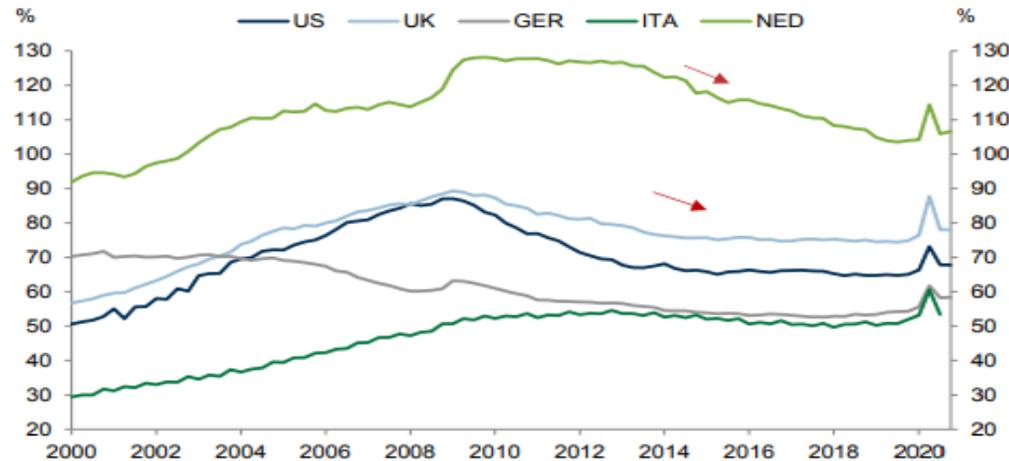
Source: Various Governments, JPM

Cyclical Backdrop: Strong Consumer Balance Sheets/Business Credit Near Peak

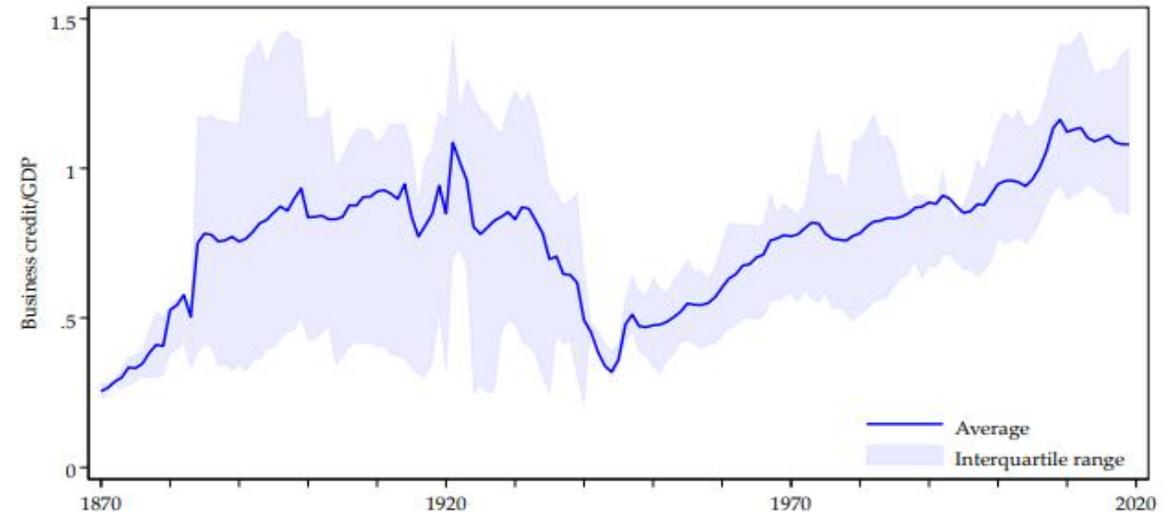
- Unlike GFC when household debt to GDP ratios reached new peaks...
- Household debt to GDP ratios relatively low in major DMs currently
- In contrast, business debt is currently near top of historical range for most advanced countries
- Lockdown creating some stresses, particularly in service industries
- Recent study found no evidence that corporate debt booms result in deeper output/investment declines¹

Household Debt to GDP Ratio

Household debt outstanding as a percentage of annual GDP



Business Credit/GDP Since 1870*



* Figure shows non-financial business credit over GDP for 17 advanced countries

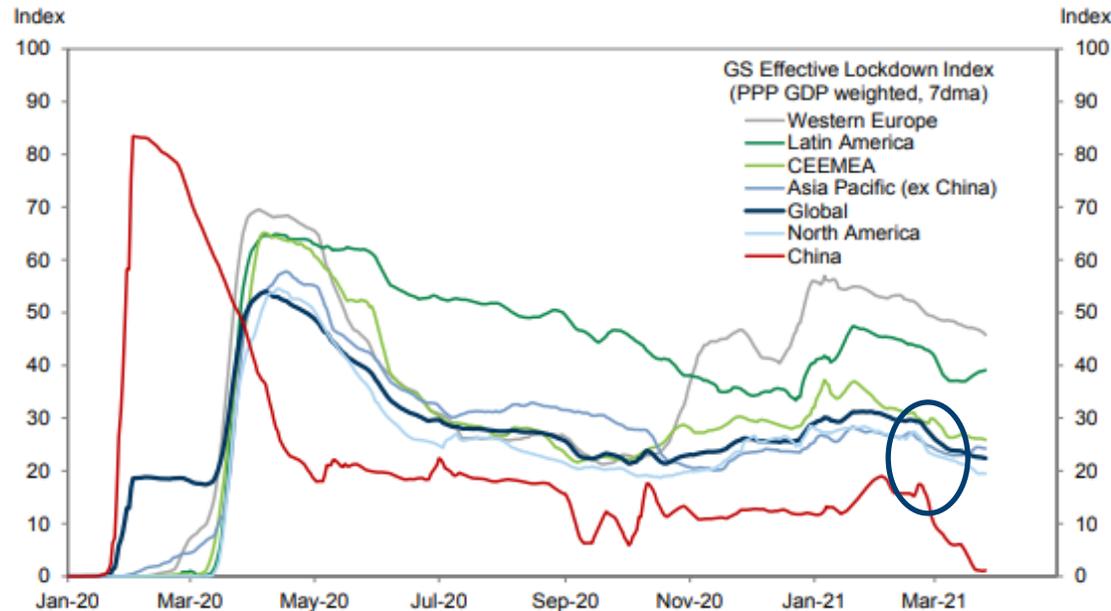
1. Zombies at Large Corporate Debt Overhang and Macroeconomy (December 2020) FRB of NY, Oscar Jorda, et al
Source: Haver Analytics, GS, NY Fed Paper

Macro Backdrop: Global Effective Lockdown Index & Global Manufacturing

- Global lockdowns (dark blue line) still headwind for global economy but much less than a year ago
- Index helpful for relative comparisons but with economic activity - particularly manufacturing - less susceptible to lockdowns, latest reading may overstate force of current headwind

- Global manufacturing PMIs, business equipment spending, capex and trade have recovered to or above pre-pandemic levels

Global Effective Lockdown Index



Global manufacturing Expectations Index



Source: Oxford U, Google, GS, JPM

Key Factors and Risks Underpinning Outlook

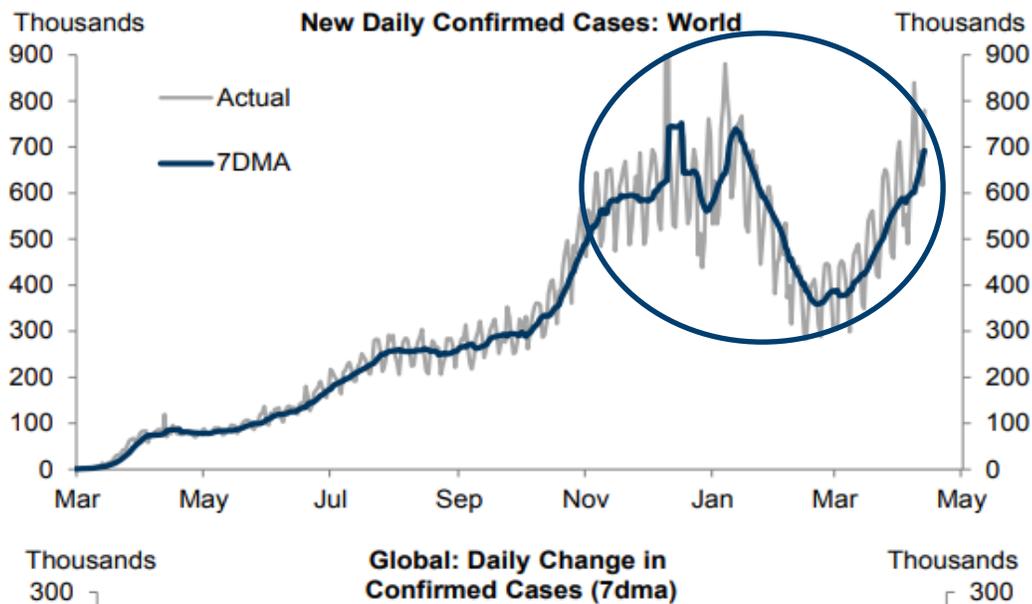
- Course of Covid-19/Vaccinations
- Latest Inflation Data/Reflation Risks
- Record Public-Debt Levels

Covid-19: Continuing But Evolving Global Challenge

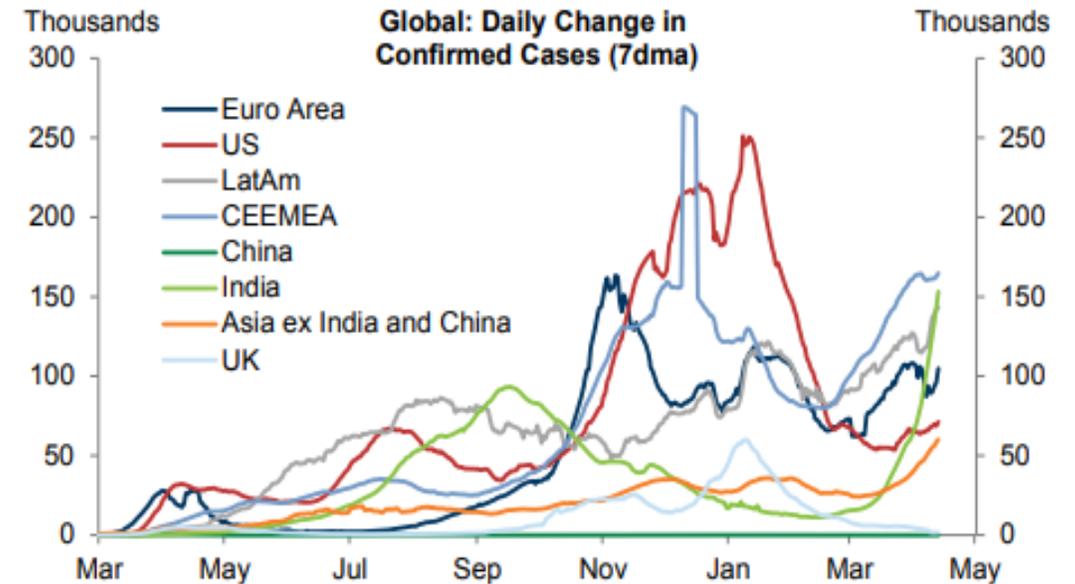
- New global case growth has followed U-shaped path since start of year Initially...
- Declining and then returning to January peak
- Significant changes, however, have taken place in composition

- New case growth is down significantly in the US and UK and moderating in Euro Area
- But new cases in India and Latin America are up materially from their January troughs

Global: New Daily Cases



Major Regions/Countries: New Daily Cases



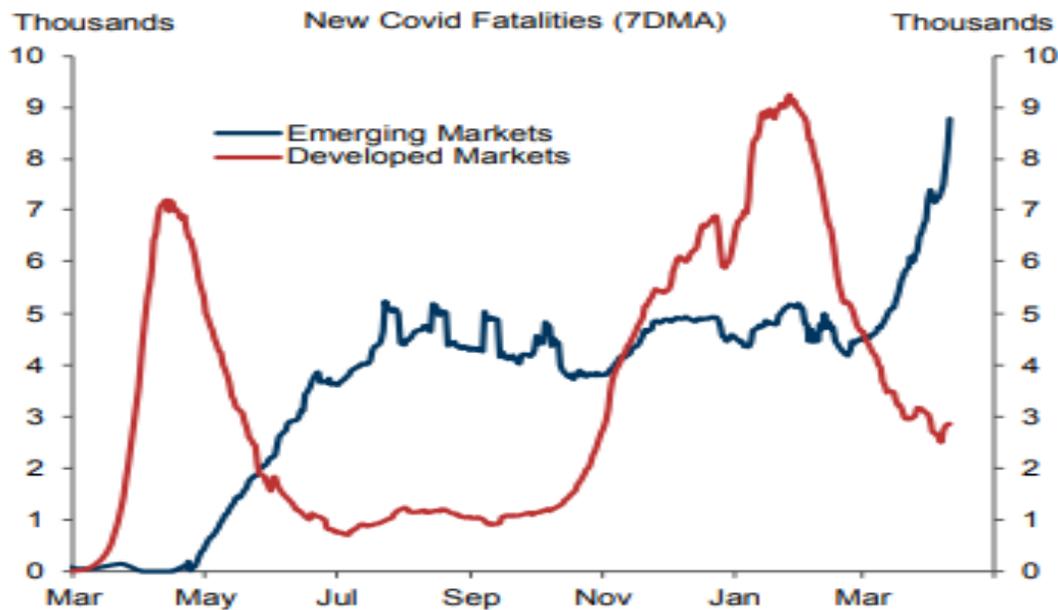
Source: JHU, GS

Recent Covid-19 Trends: DM & EM Fatalities/ New Cases in DM, India & South America

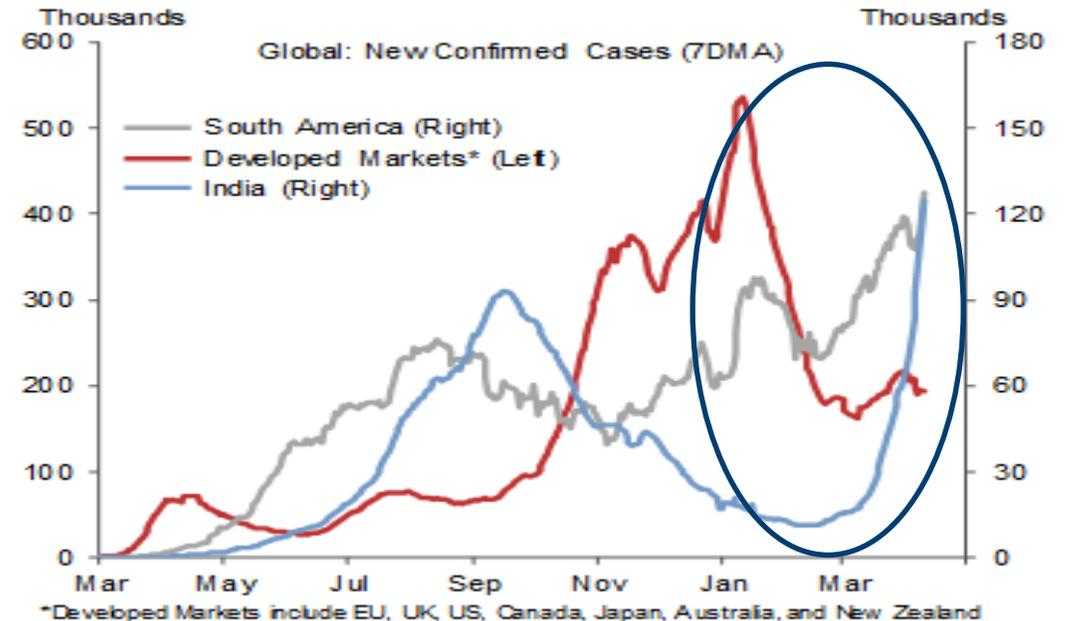
- Daily DM fatalities have fallen 70% from January peak
- In contrast, EM fatalities are rising sharply largely due to recent surges in India and South America

- New cases have risen rapidly in India and South America to ~120K per day currently¹
- DM new are currently ~200K per day, down from ~500K per day in January

New Covid-19 Fatalities



New Cases: DM, India & SA



1. India's new cases per day in January ~15K and South America's ~70K.

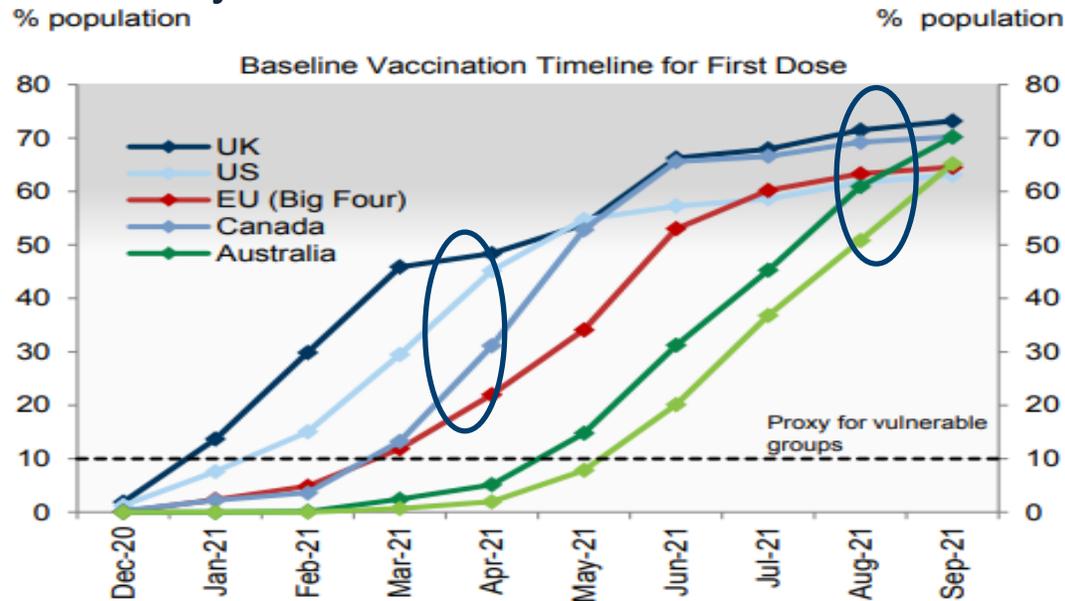
Source: JHU, GS

Covid-19: Vaccinations/ DM & EM Progress Toward Immunity

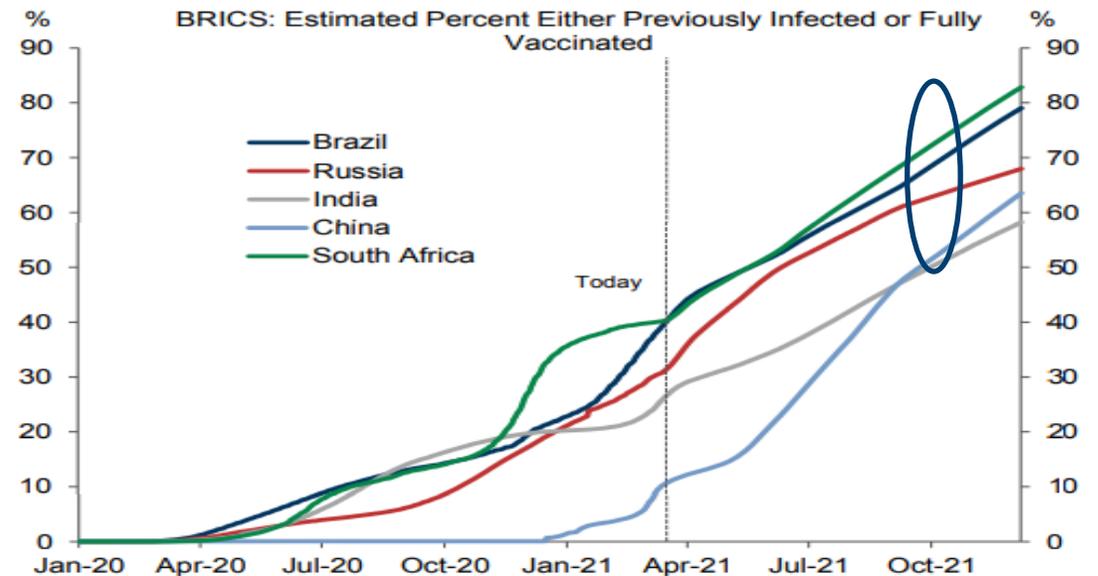
- In major DMs (including the UK, US, Canada and the Euro area) percent of population vaccinated ranges from ~20% to ~50% currently vs ~0% at YE'20
- By yearend ~65% -75% of population of DMs are expected to have received at least one dose

- Vaccinations off to slower start in EMs but including antibodies from prior infections ~10 % to 40% of populations of major EMs have some immunity
- As vaccine supplies increase ~60% to~ 80% of the population of the major EM are expected to have some immunity by yearend

Major DMS: Timetable for 1st Dose



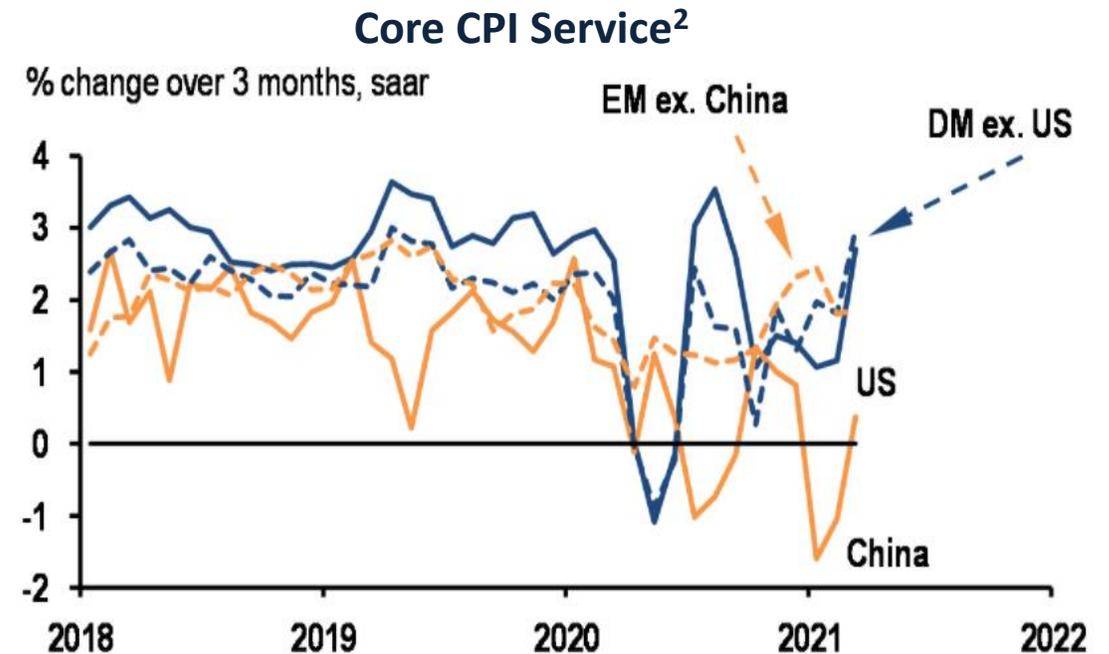
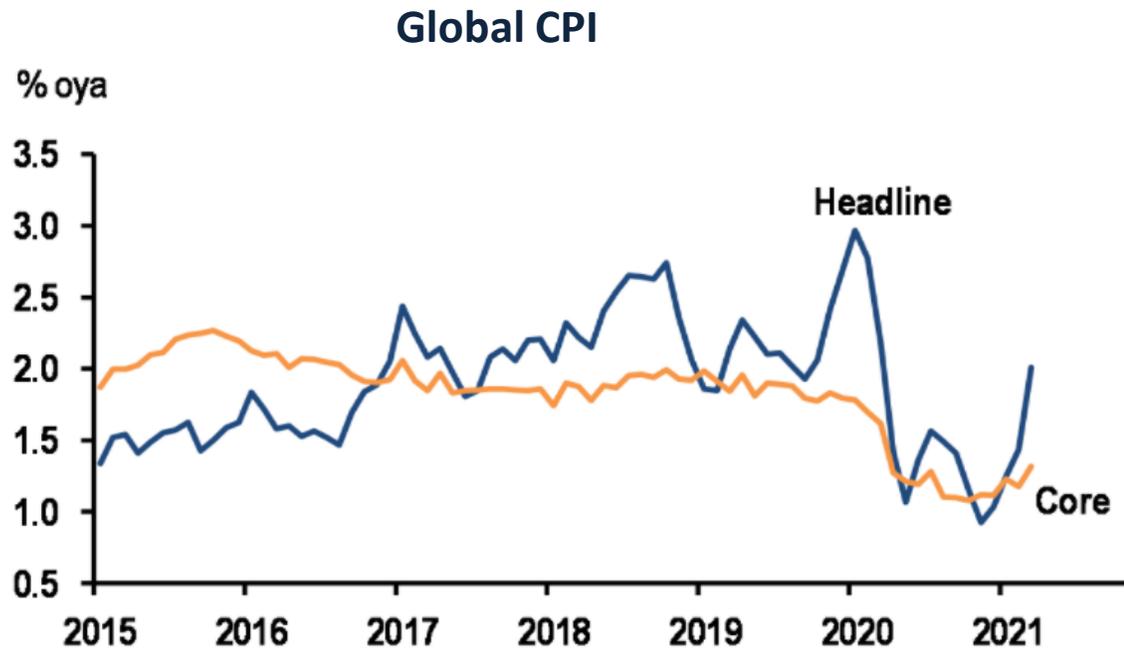
Major EMs: % of Population with Some Immunity¹



Source: GS

Inflation: Strong Rebound Evident In Latest Data

- Effects of accelerating activity on latest inflation data magnified by base effects¹ and bottlenecks
- Sharp jump in headline inflation in March largely due to oil prices
- Service prices increased sharply over the course of Q1, largely due to pent-up demand
- As vaccinations increase, normalization of service prices from depressed levels is expected to generate a significant rebound in price levels



1. Occurs when base or initial month, of a growth rate is unusually low or high

2. Plotted thru end of February

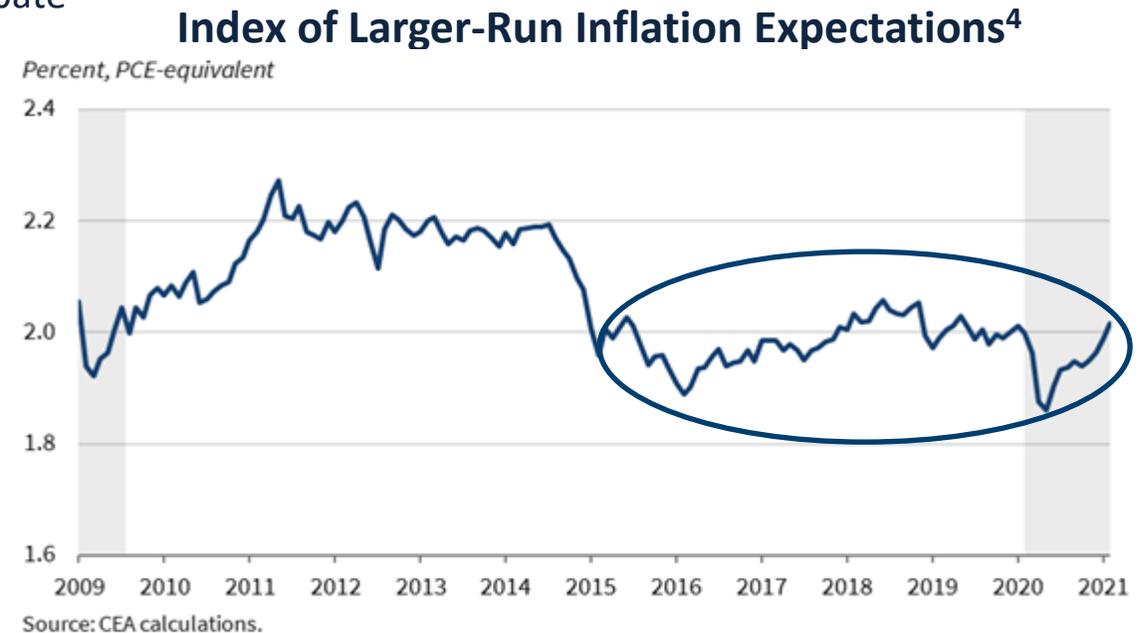
Source: JPM

Inflationary Surge Tracking January Outlook/US Fiscal Policy Providing “Food for Thought”

- Current Acceleration/Rising Inflation Expectations Largely due to:
 - Base effects and pent-up demand referenced in January
 - Supply chain disruptions¹/idiosyncratic factors in Euro area expected to be transitory²
- US: Focal inflation concern among major DMs over ‘21-22 cyclical horizon
 - Economy expected to rise above pre-pandemic level before DM counterparts³
 - Extraordinary fiscal stimulus prompting reflation debate

	CPI	Forecast	Forecast
	<u>2020 (%)</u>	<u>2021 (%)</u>	<u>2022(%)</u>
US	1.3	2.5	2.1
Euro Area	0.3	1.5	1.2
UK	0.9	1.6	1.9
Japan	0.0	-0.1	0.7

Source: SECOR, IMF



1. Supply chain disruptions are typically transitory , e.g., price of lumber or energy rise, but then stabilizes or decreases with no further impact on future inflation
2. Temporary changes in German VAT and reweighting of inflation index
3. Real GDP 2.4% yoy in US in late 2020 vs 5% in Europe & 8% in UK
4. Monthly composite measure of 22 different market and survey indicators of inflation expectations

Reflation Debate

- **Concerns About Overheating Largely US Phenomenon for Now, at Least Among Major DMs¹**
 - Unprecedented fiscal stimulus/High vaccination rates/Recoveries in other major DMs starting from deeper holes
- **Mainstream Economists³ - - \$1.9 Trillion Stimulus Package Passed in March Raising Concerns**
 - Unemployment rate declining when latest stimulus enacted
 - Sending \$1,400 checks to millions of Americans financed by new debt when \$1.5- \$2 trillion of excess savings also available...
 - Risks that subsequent spending boom that will more than close output gap and...
 - De-anchor inflation expectations and shift Phillips curve⁴
- **Case for US Core Inflation Not Rising Materially Above 2% Over Cyclical Horizon**
 - Slack in economy much greater than widely used metrics imply
 - Effective unemployment rate ~10%, not 6%⁵/estimated output gap ~6%, not 3%⁶
 - Much of stimulus temporary and one-off payments
 - Unemployment benefits will expire or scale down/fiscal stimulus expected to decelerate next year⁷
 - Only roughly two-fifths of core PCE very responsive to cyclical factors
 - Affordable Care Act has made health care disinflationary

1. EM inflation largely constraint but some 2021 exceptions including Turkey (14.6%), Brazil (4.5%), Russia (4.9%)

2. US fiscal stimulus since April 2020 has totaled \$5.3 trillion

3. Former Treasury Secretary Larry Summers and former Chief IMF economist Olivier Blanchard

4. Blanchard points out that in early 1960s when inflation started to rise (from 1% to ~3%) expectations remained anchored but in 1967 when inflation edged higher they adjusted rapidly

5. Janet Yellen: because 4 million people have dropped out of labor force because of child-care responsibilities during pandemic, effective unemployment rate is close to 10%

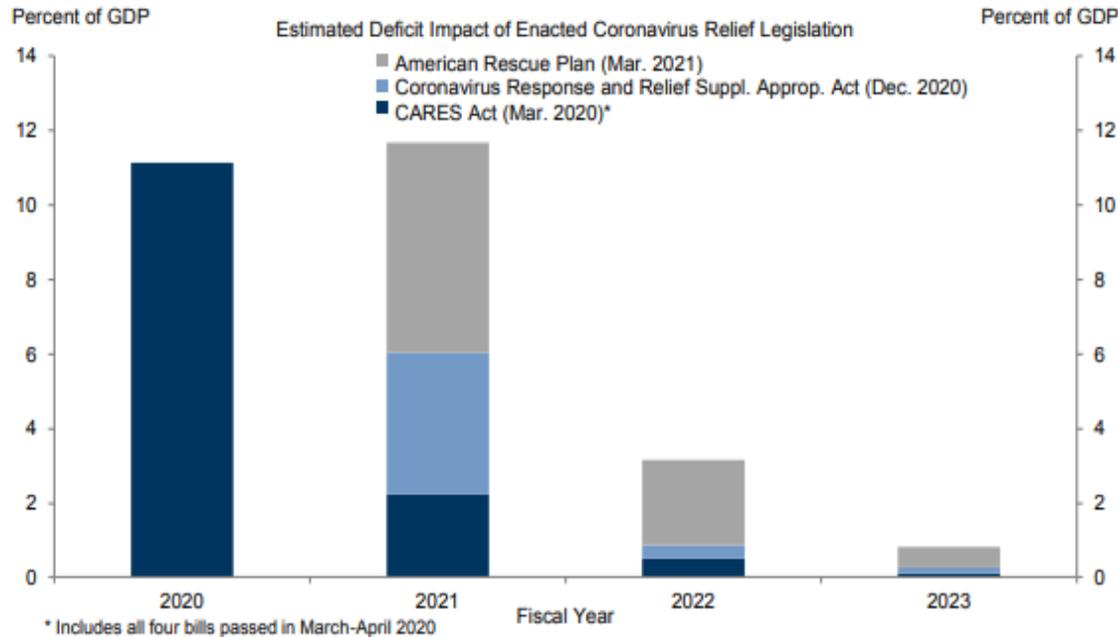
6. GS economists contend CBO estimated output gap (3% at YE 2020) is too low. CBO showed economy running above potential in two years before pandemic while inflation remained below target

7. Infrastructure and other fiscal measures totaling ~\$3+ trillion likely to be spread over 10-year period and be partially offset by higher taxes

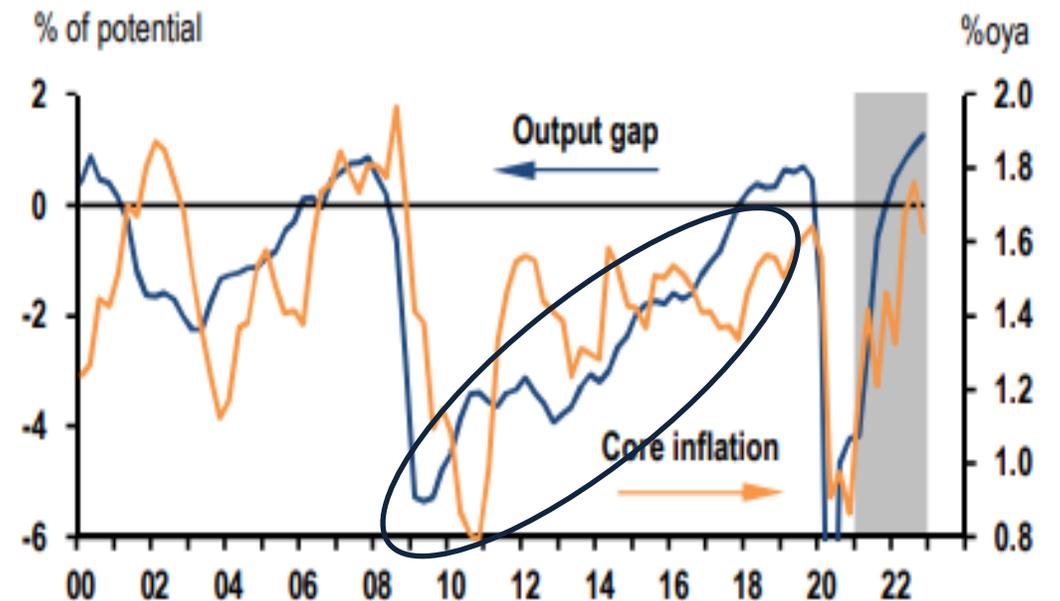
\$5 Trillion US Fiscal Response to Pandemic/DM Output Gap Narrowing

- Congress has passed three major Covid-19 relief measures in the past year
- Roughly \$4 trillion of these relief allocations are expected to be spent by the end of this year before dropping sharply in subsequent years
- Output gap difficult to measure and questions remain concerning its size
- Virtual agreement closing much faster than post GFC

Covid-19 Relief Measures



DM Output & Core Inflation



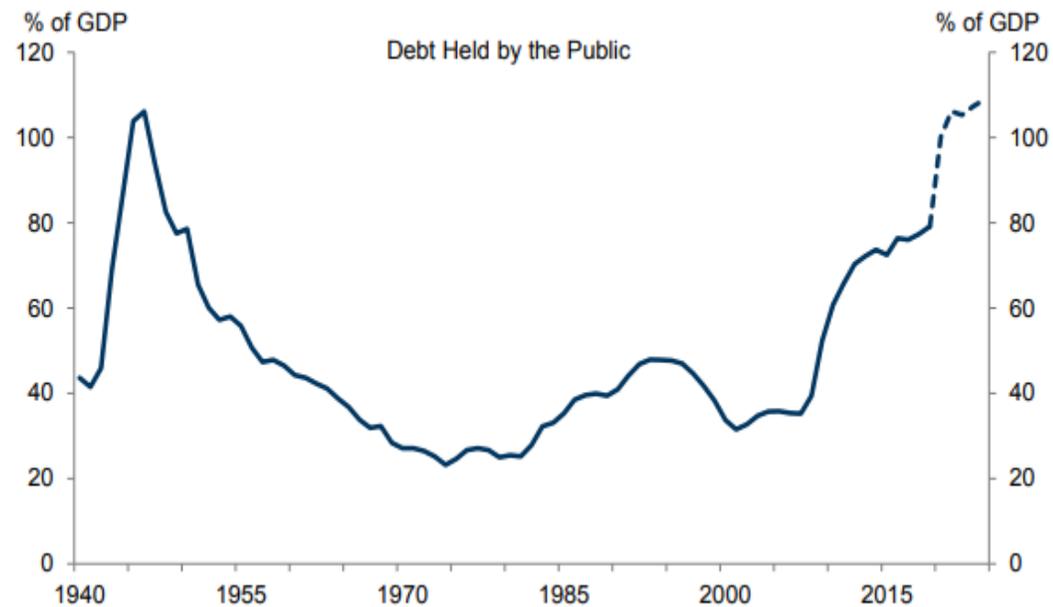
Source: Congressional Budget Office, GS, JPM

Record Public Debt Levels/Low Rates: New Thinking re Seeming Sustainability ¹

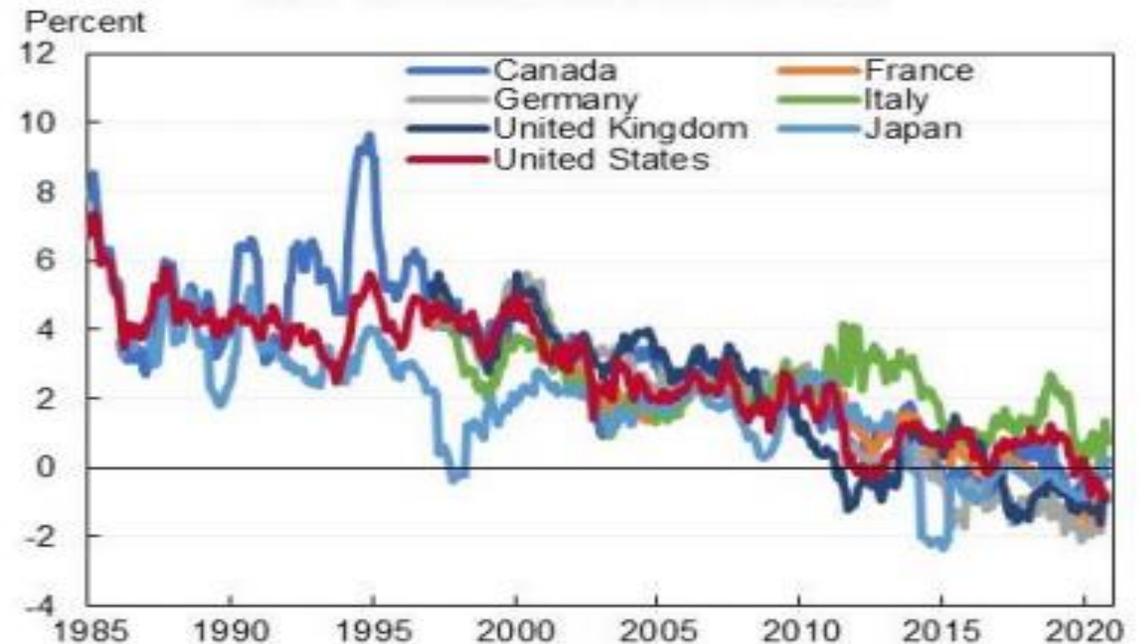
- Ratio of US federal debt to GDP rose to ~100% last year
- Will soon surpass World War II peak, reaching highest level in US history

- Global rates near historic lows
- Some argue current low rates make fiscal expansion affordable and perhaps attractive

US Federal Debt to GDP Ratio



Real Ten-Year Benchmark Rate



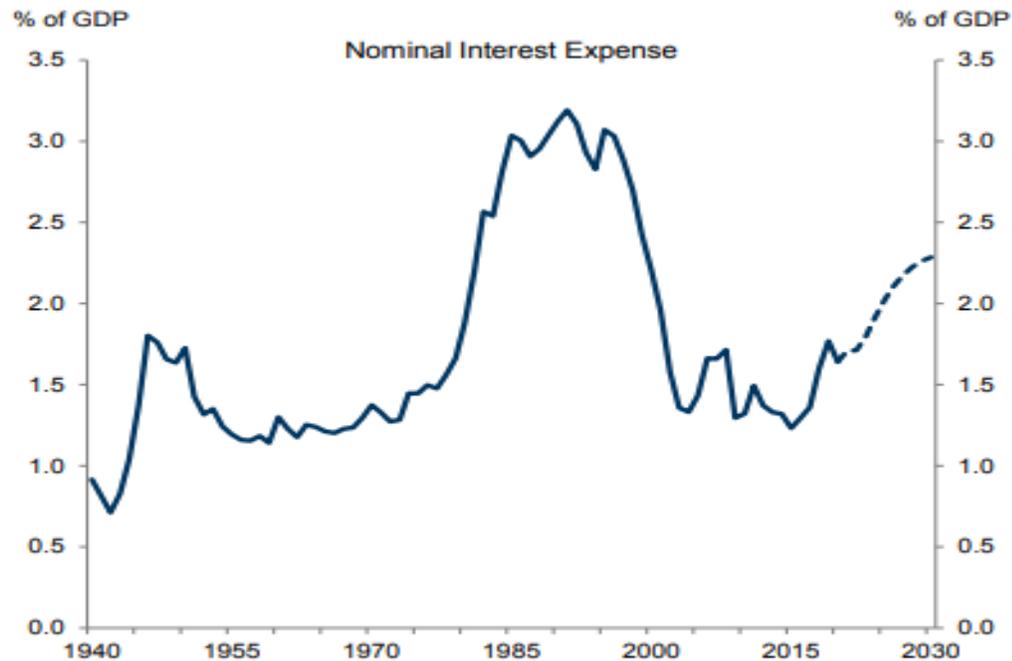
1. Key inputs: Panel discussion at Brookings Institute (December 2020), Furman/Summer paper (Nov 2020)

Source: Office of Management and Budget, GS, Various central banks, Furman Summer

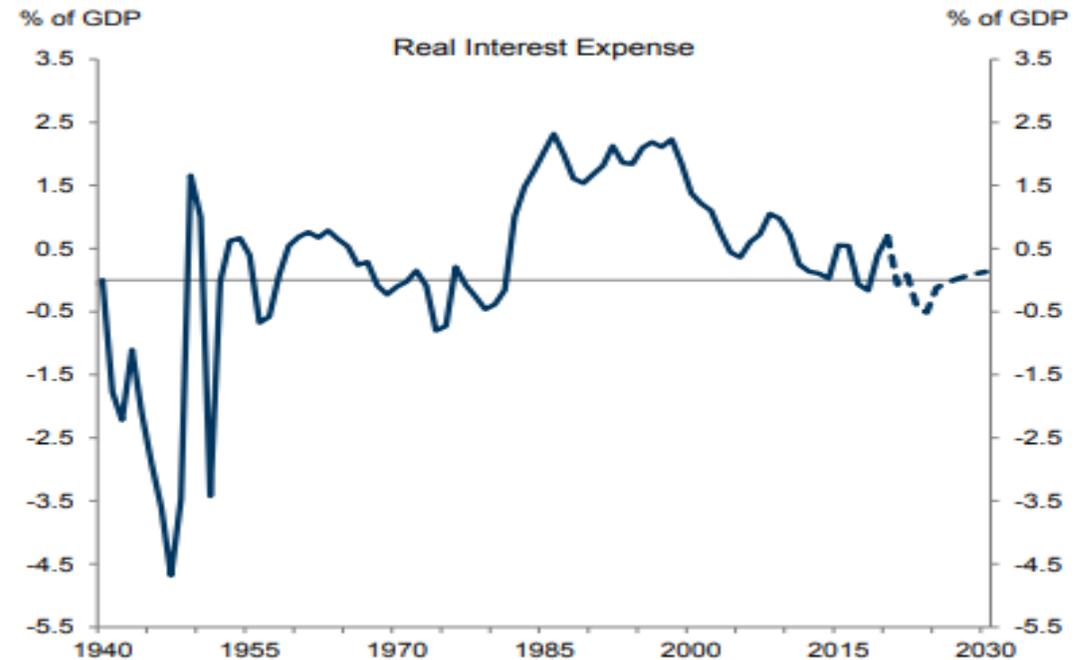
Debt Servicing Costs: Principal Factor Generating New Thinking

- Debt servicing costs far below recent peaks
- Even with some further modest increases in rates¹ over the decade ahead, servicing costs expected to remain manageable
- If the impact of inflation on debt levels and interest costs taken into account ...²
- Possible to argue real servicing costs could edge down from ~1% to ~0% by 2030

Interest Expense as % of GDP



Real Interest Expenses % of GDP



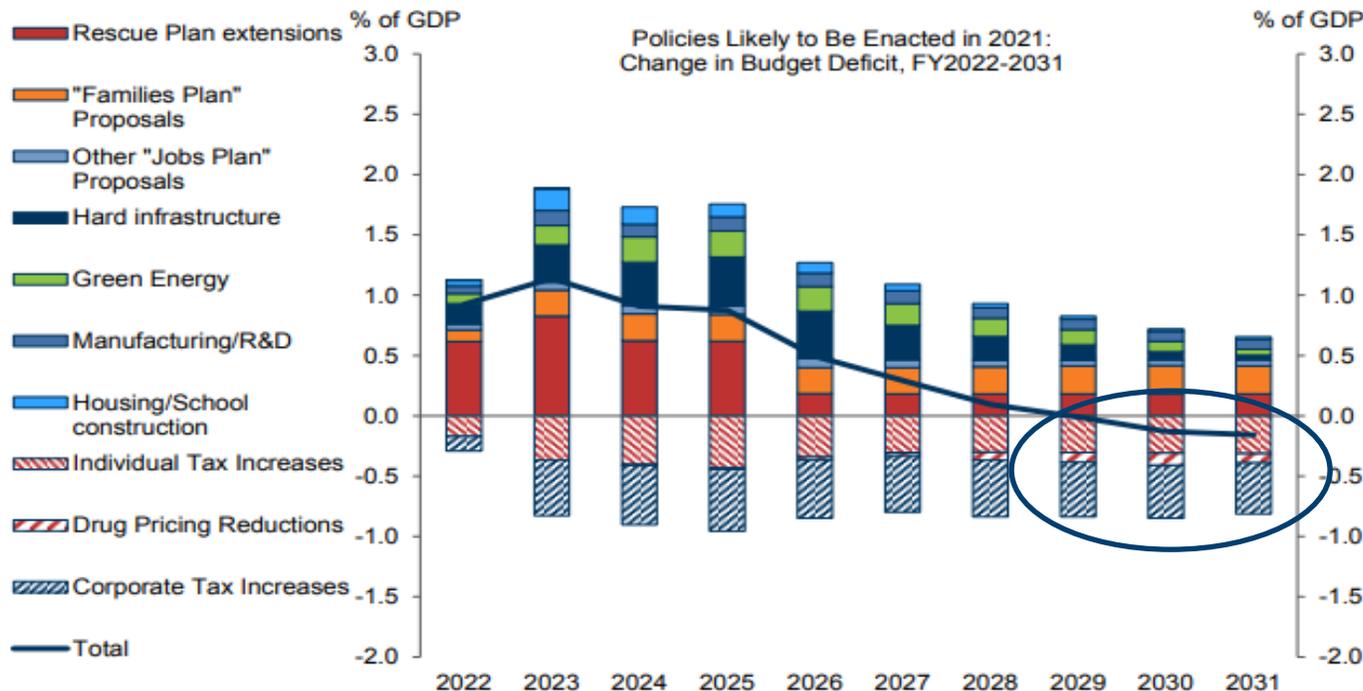
1. GS expects policy rate to return to Fed's long-run normal ~2.5% over the course of the decade
2. Furman and Summers recommend subtracting the stock of debt that is "inflated away" each year from interest payments

Source: Office of Management and Budget, GS

Biden Administration's Announced/Forthcoming Fiscal Proposal

- Recently accounted American Jobs Act \$2 Trillion (infrastructure plan)
 - Estimated net effect of spending/tax proposals would increase 2031 gov't debt by 1.7%¹
- Forthcoming American Family Plan expected to be roughly comparable in size

Proposed Plans: Expected Size/Components



- GS assumes ~3.3 trillion -- most of proposed plans -- will be passed this year
- Expected tax increases assume 25% corporate increases and 28% capital gains rate
- By end of decade projected to be net source of revenue

1. Penn Wharton Budget Model estimate
Source: White House, Various Gov't Agencies, GS

Some Caveats Re Sustainability of US Public Debt Servicing Costs

- **Current Estimates Do Not Include Possible Increases to Meet Promised "Entitlements"**
 - Medicare Insurance Trust Fund is expected to be depleted in 5 years¹
 - Social Security Trust Fund not expected to be able to pay full benefits beyond 2032²
 - Policymakers will face difficult choices of raising taxes and/or reducing benefits
- **Estimates Assume Policy Rate Gradually Moves to Fed's Neutral Rate (~2.5%)**
 - Service costs estimates vulnerable to higher rates
 - UBS economists project that with a 3.4% 10-year Treasury yield ...
 - Debt servicing costs as % of GDP would return to their late 90s peak of ~3%
- ***"Longer Current Policies Proceed as if Limits Don't Exist, the More Likely They Will Hit Them"***³
 - Concerns that as new limits for debts sustainability are tested cautions warranted
 - But, in my opinion, debt levels will not be a major problem over '21-'22 cyclical horizon
 - Presuming that the Fed can, indeed, continue to hold rates "low for longer"

1. Bipartisan Policy Center of AEI (March 2021). based on current estimates without raising taxes Medicare would be able to cover only 89% of hospital and insurance payment in 2026.

2. Social Security trust fund is expected to be no longer able to pay full benefits starting in 2032 based on estimates from Wharton School study.

3. Paraphrased quote from Greg Ip's article (April 8, 2021) WSJ.

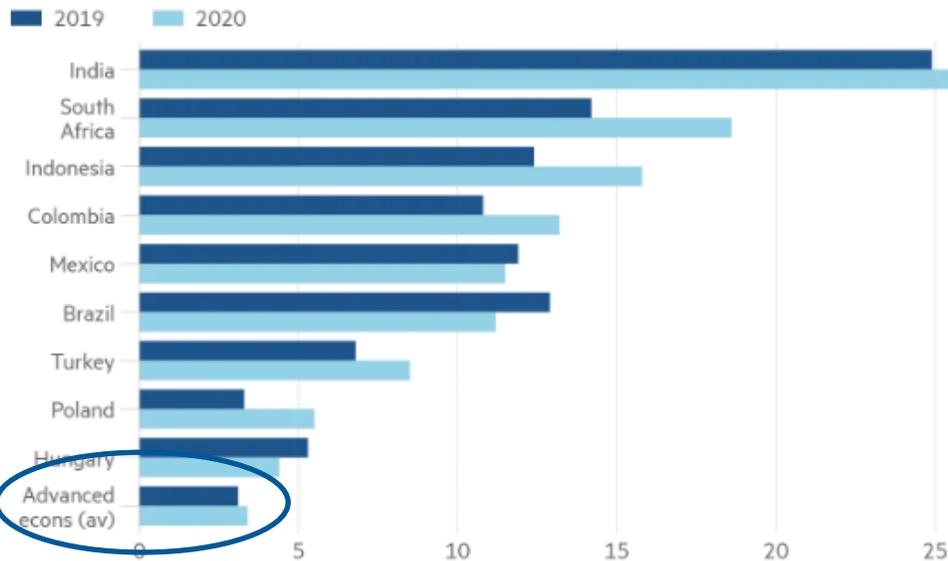
Debt Servicing More Challenging for EMs

- DMs average share of government revenue spent on servicing public debt 3.3% in 2020
- In contrast, EM average share of government revenue spent on servicing public debt 10.4% in 2020

- Servicing costs seemingly manageable for high growth EM such as India
- But more challenging for moderate growth EM such as South Africa and Brazil

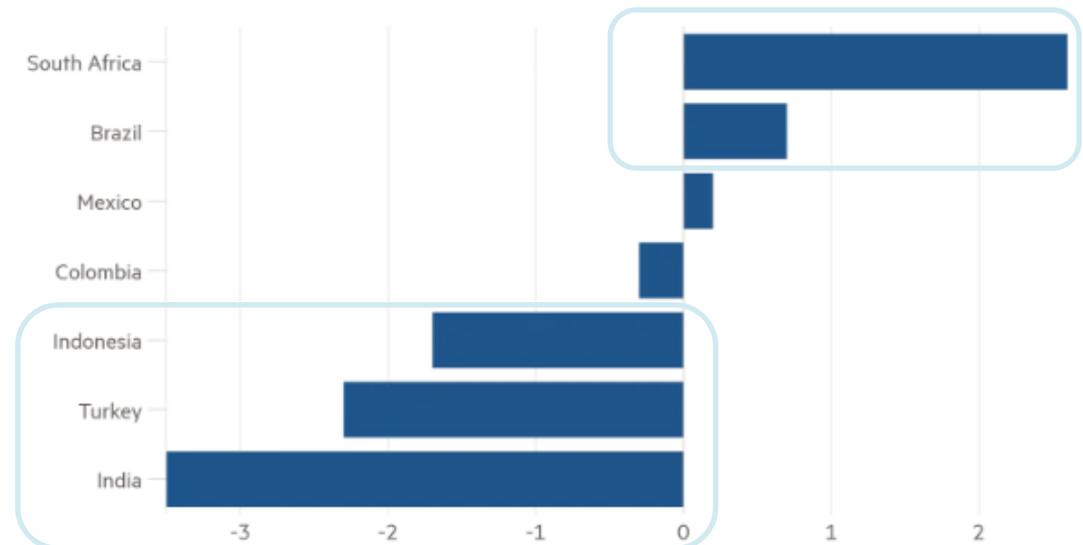
Debt Servicing Costs: EMs vs DM Avg.

Share of government revenues spent on public debt interest payments, %



Growth & Interest Rates

Annual interest rate minus rate of GDP growth, %



Source: Fitch, IIF

Major Countries /Region/ Grouping

- US
- Euro Area
- UK
- China
- EM
- Selected Countries/Regional Forecasts

US Cyclical Outlook: Economy “Surging”

- **Arrows Aligned for Robust Above-Trend Growth in ‘21 and ‘22¹**
 - Significant fiscal stimulus
 - \$1.9 trillion package enacted in March, brought one-year total to ~\$5 trillion
 - Proposed jobs and family programs multi-year initiatives with partial tax offsets
 - Not expected to have material-cyclical effect on budget deficit but higher taxes could affect earnings²
 - Fed’s average inflation targeting mandate provides...
 - Leeway to maintain near-zero policy rates over cyclical horizon, despite current transitory inflation rise
 - Latest data consistent with optimistic outlook
 - Retail sales up 9.8% in month of March, initial jobless claims and consumer sentiment back to pre-pandemic levels
- **Some Questions Being Raised About Reflation and Debt Sustainability**
 - Few question economy’s near-term strength

1. SECOR’s outlook: US GDP growth outlook raised to 6.5% for 2021, up from 5% in January. 4% growth for 2022

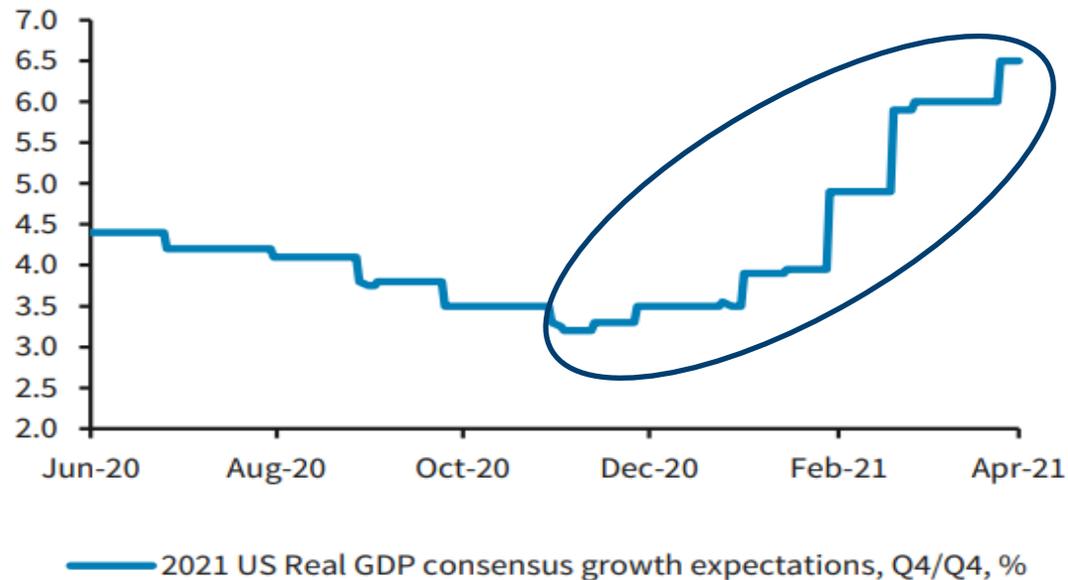
2. Capital Economics estimates that raising corporate tax rate to 28% could result in a 5+% hit to S+P 500 earnings

US Cyclical Outlook – cont'd

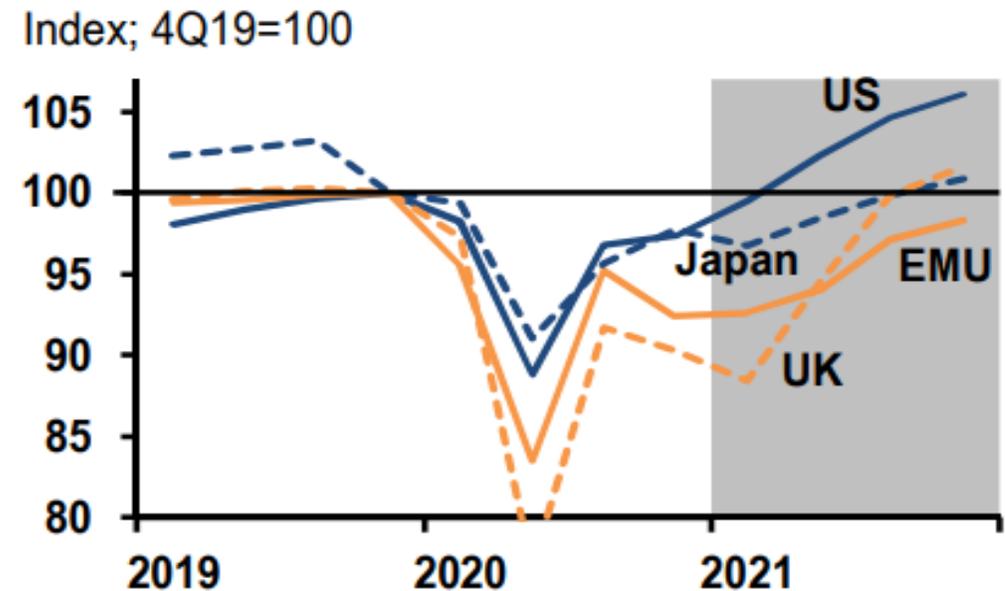
- Consensus outlook currently calls for 6.5% (Q4/Q4) US GDP growth in 2021 vs 3.5% at the beginning of the year

- US upside outlier due to outsized fiscal stimulus accompanied by strong start of vaccination program
- All of major DMs expected to experience rebounds in personal consumption expenditures this year

Consensus US GDP Outlook



Personal Consumption Expenditures



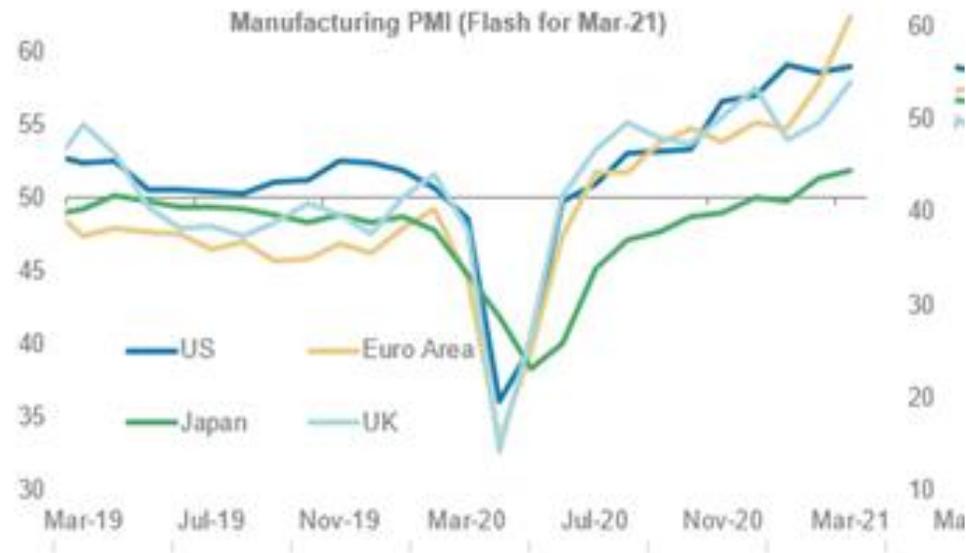
Source: Bloomberg, Barclays, JPM

Euro Area Cyclical Outlook

Factors in Place for Strong Rebound as Latest Lockdowns Are Relaxed

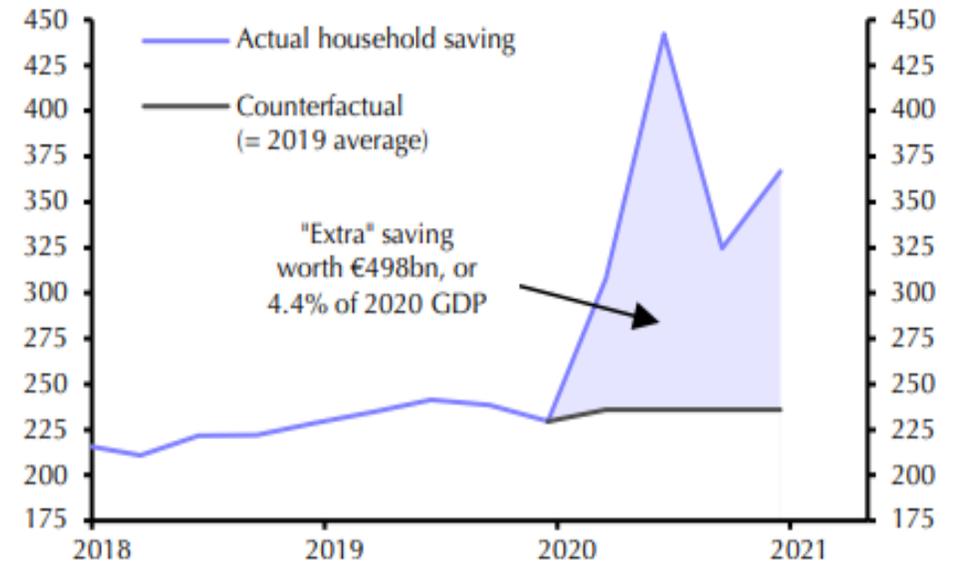
- Virus controls/vaccination and excess saving expected to unlock pent-up demand
- Manufacturing buoyed by strong global recovery
- Supportive monetary and fiscal policies¹

Robust Manufacturing Sector



Source: Haver Analytics, MS

Euro Area: Extra Saving



Source: Refinitiv, CE

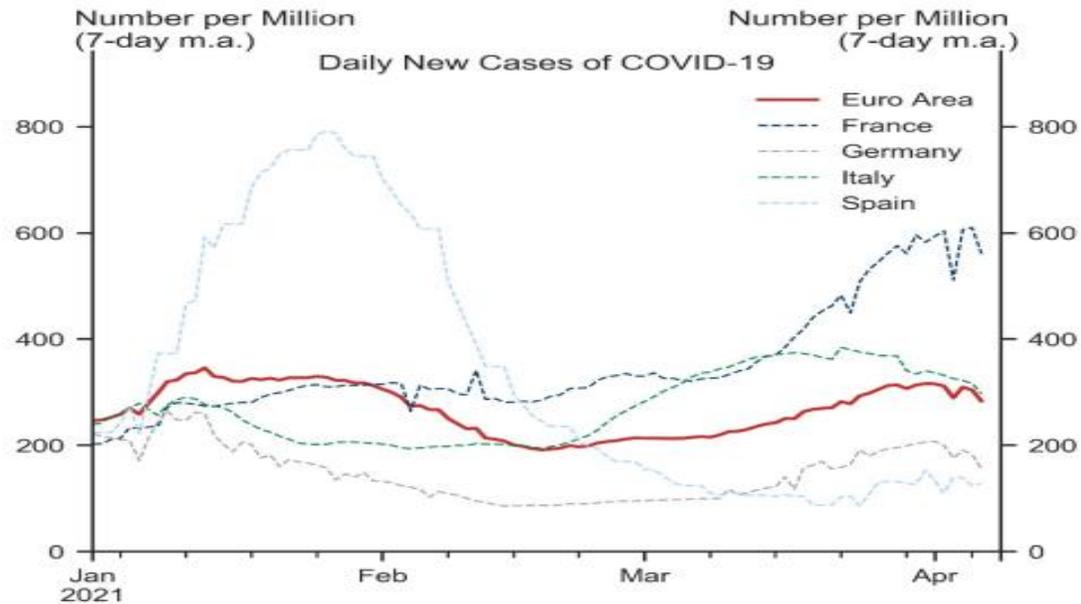
1. Expect ECB to keep policy rates on hold over cyclical horizon and beyond. Re fiscal policy, the Eur 750 billion Recovery Fund is expected to be ratified and disbursement to start in the later half of the year.

Euro Area Cyclical Outlook-cont'd

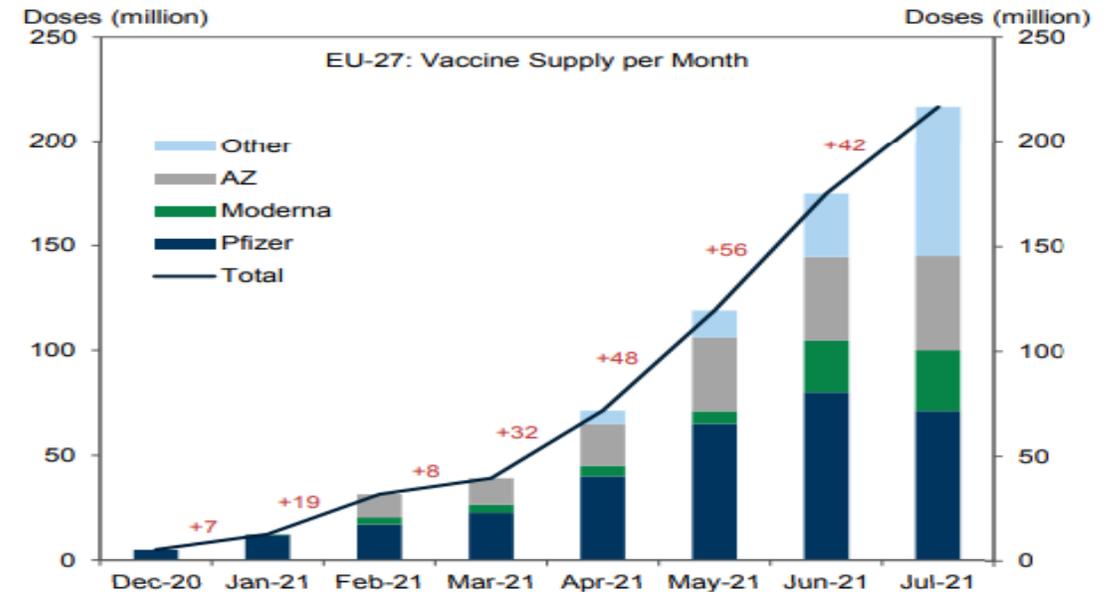
- New Covid-19 cases have started to fall across Europe (redline)
- Infections declining significantly in major countries (ex France)

- Vaccinations and supplies finally speeding up
- Now on track to vaccinate 50% of population with first dose by mid-year

New Covid-19 Infections



Vaccine Supply

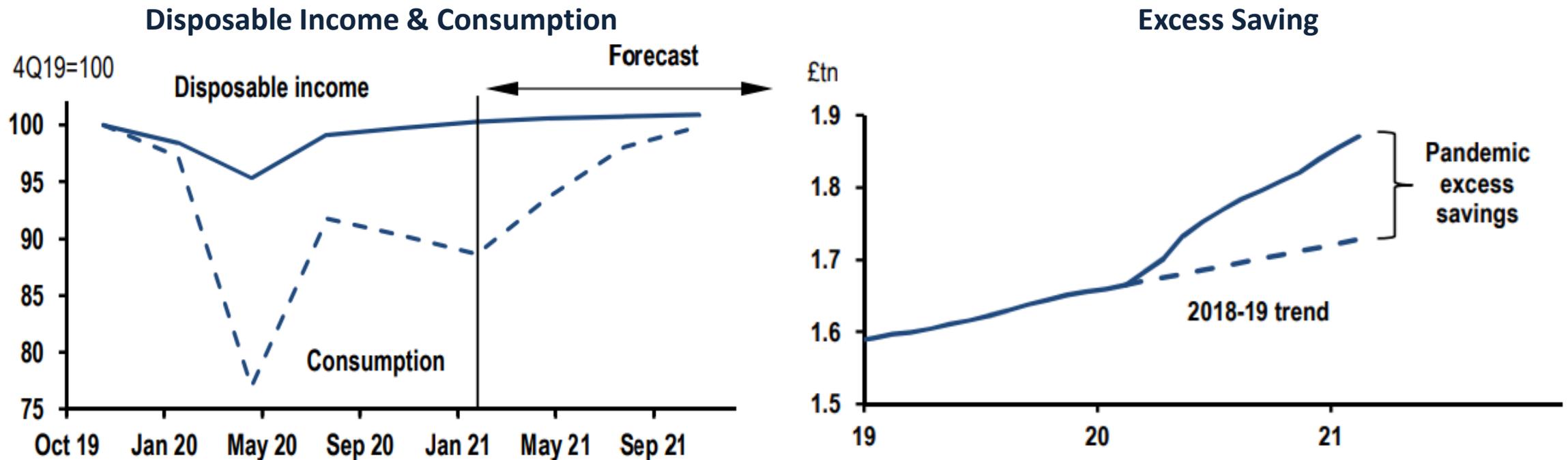


Source: Our World Data, GS

UK Cyclical Outlook

▪ Economy Reopening/Poised for Strong '21 and '22 Recovery

- Stable income/robust consumer financial positions
- Effective vaccination program/well anchored inflation expectations
- Brexit disruptions appear manageable



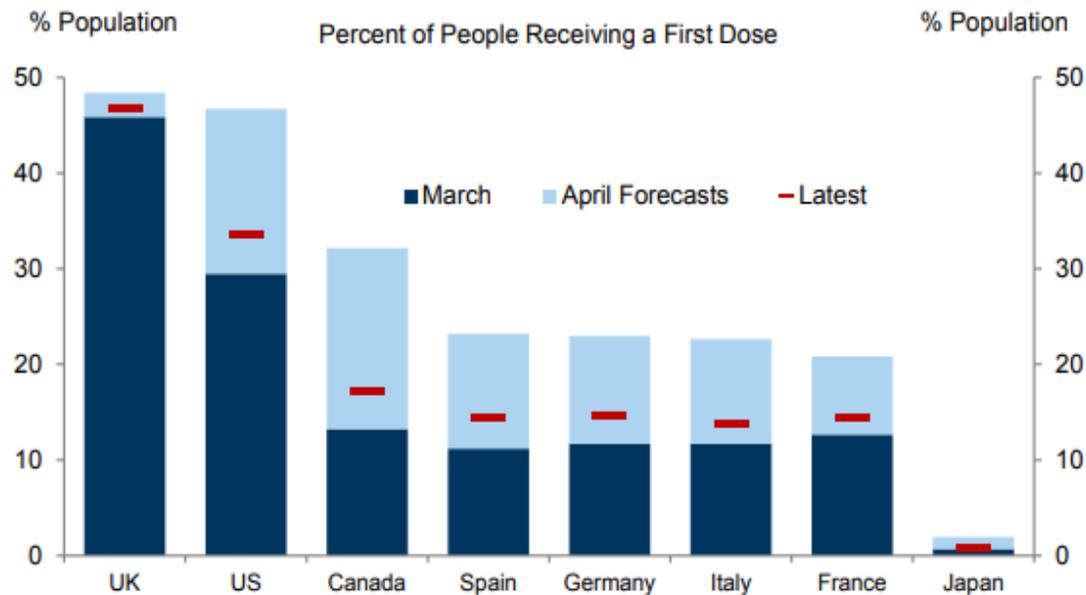
Source: ONS, JPM

UK Cyclical Outlook - cont'd

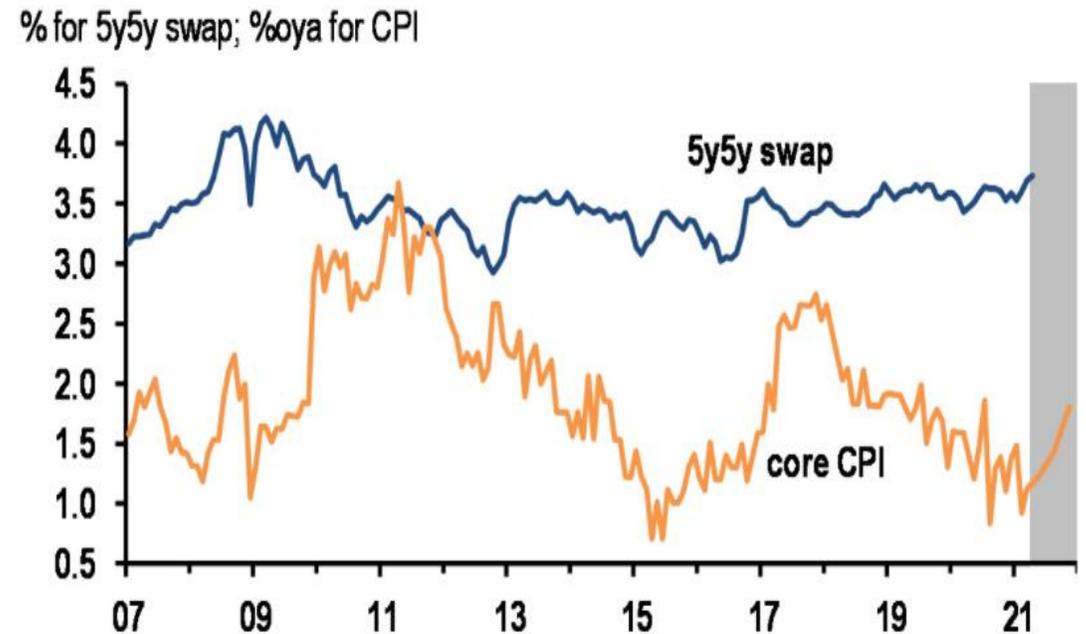
- UK a leader among major DMs in vaccine rollout
- Nearly half of population has received at least first dose of a vaccine

- Core inflation is rebounding from pandemic trough
- Sufficient slack in economy to prevent lasting inflation overshoot
- Inflation expectations remain contained

% of Populations Receiving 1st Dose



UK Inflation Swaps/Core Inflation



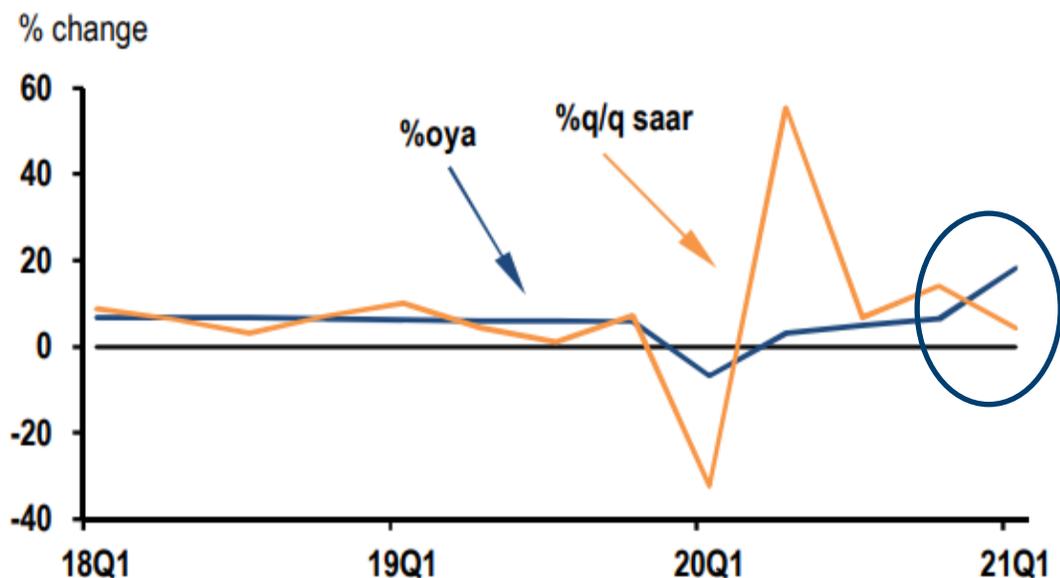
Source: Our World in Data, GS, JPM

China Cyclical Outlook

■ Economy Appears to be on Orderly path to Normalization

- -18.3% year/year gain in Q1 due largely to base effect/quarterly growth rate moderated¹
- Credit policy rotating to officials favored manufacturing projects and away from housing²
- US/China relations bear watching

Real GDP Growth



Credit Growth



1. Economy grew at 4.3% rate in Q1 vs 14.3% pace in Q4 '20

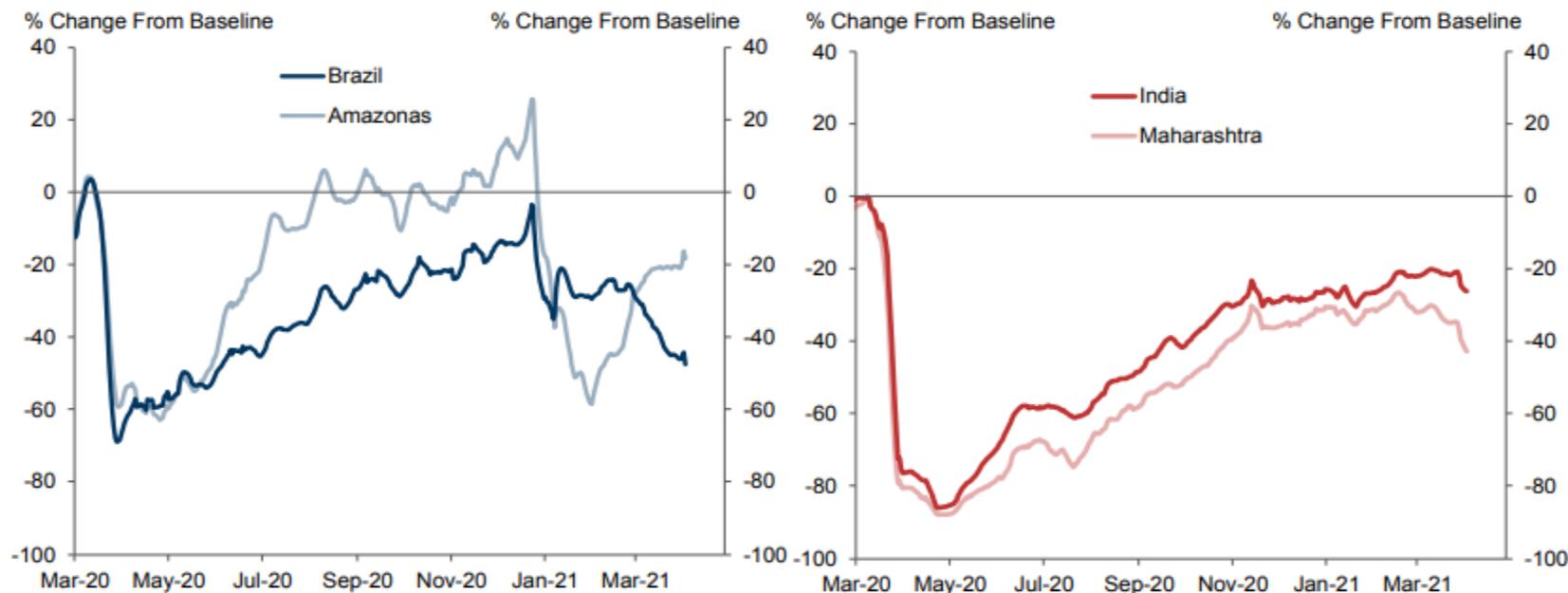
2. Favored projects include technology, innovations and green development

Source: NBS, JPM, PBOC

EM: Renewed Virus Outbreaks Constraint but Unlikely to be Game Changer

- **Recent Jump in New Virus Cases, Particularly in Brazil & India, Concern but Still Case for Remaining Positive¹**
 - Economic activity becoming less sensitive to virus and restrictions
 - Younger EM populations make it easier to vaccinate relatively elderly populations and reopen²
 - Expect 60%-70% of EM populations to have some form of immunity by YE
 - Mobility data suggest quick rebound possible once virus contained

Mobility in Retail and Recreation



1. "Will Outbreak Delay EM Recovery?" GS (11 April 2021)

2. Share of over 65-year-olds in population: India (7%), Brazil (10%), Japan (29%)

Source: Google, GS

Selected Country/Regional Forecasts

	GDP Growth %		
<u>Major DMs</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>
US	-3.5	5.0 6.5	4.0
Euro Area	-6.8	4.8 4.5	4.3
UK	-9.8	6.0 7.0	5.0
Japan	-4.8	3.0 2.9	2.5
<u>Major EMs</u>			
China	2.3	9.0 8.7	5.6
India	-7.0	11.0 10.5	7.0
Brazil	-4.1	3.0 3.2	2.5
Russia	-3.0	3.0 3.5	3.0

2021

- US and UK: Outlooks revised upward significantly since January
- China and India: outlooks lowered somewhat since start of year

2022

- Global growth expected to remain strong and above trend but moderate from extraordinary 2021 pace

Pulling it All Together: Global Macro Cyclical Outlook

- **Factors in Place for Even Stronger Growth Than Forecast in January**
 - Expected '21 global GDP growth raised to 6.5% from 6% / above –trend 4.5% growth forecast for '22
 - Incremental fiscal stimulus, particularly in US, a key factor underpinning increased optimism
 - Vaccinations, despite some setbacks, making significant progress
 - Producers expect to provide 10 billion doses by YE, sufficient to vaccinate world's entire adult population
 - Limited scarring from pandemic recession, consumers in strong financial position
 - Central bankers focusing on anchored inflation expectations rather than recent price surge
 - UK and Europe poised to reopen and experience strong growth
- **Principal Identifiable-Cyclical Risks Appear Manageable, Though Warrant Monitoring**
 - Current inflationary pressures largely due to transitory factors...
 - Such as base effects but possibility of reflation can't be dismissed
 - Record public debt levels serviceable in low-rate environment and equities attractive relative bond yields but...
 - Both vulnerable to higher rates
- **All in All, There Appears to be Compelling Case for Near-Term Cyclical Strength but...**
 - Important questions remain about the possible long-term consequences of unprecedented public debt levels

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