



SECOR Asset Management
Quarterly Macroeconomic Outlook Update
August 11, 2021

Global Macroeconomy: August Update

- **Identifiable Potentially Important Changes Since April**
 - Inflation higher than expected
 - Delta variant propelling new wave of Covid-19 cases
 - China’s crackdown on superstar companies
- **Policy Makers, Consumers and Investors Seemingly Undaunted by Latest Risks**
 - Major central bankers attributing inflationary surge to transitory factors
 - Effects of Delta wave on global economic growth relatively small thus far¹
 - Lockdowns contributing to bottlenecks and price pressures but
 - Vaccinations making considerable, albeit uneven, progress / DMs leading EMs
 - Efficacy high against severe illness, hospitalizations and fatalities
 - China’s crackdown concern for investors² but near-term effects on domestic and global economies...
 - Expected to be limited

1. The Delta variant had a devastating effect on some EM economies, particularly India, in Q2 but a rebound is expected in the current quarter and global growth is still expected to increase > 6.5% for the full year

2. China’s crackdown on some superstar companies is an important consideration for investors but near-term consequences for macroeconomy ambiguous. Re equity markets, GS strategists contend EMs (ex china) resilient, HSCEI index ~26% below Feb peak but other major EMs such as Brazil, Mexico, India, Russia and South Africa have risen an average of 5% in USD term over some period (8/3/21). Actions consistent with leaders’ goals of reducing inequality, enhancing manufacturing prowess and achieving autonomy from foreign suppliers. Leaders attacked social media and e-commerce companies such as Alilbaba, Tencent and Didi and left alone “essential” industries such as semiconductors, electric car batteries, commercial aircraft and telecommunications equipment.

Global Baseline Cyclical Outlook (2021 and 2022)

- Factors in place for robust above trend growth over '21-'22 period¹
- Uneven vaccination progress narrowing traditional EM-DM growth differential²
- Policies expected to remain highly accommodating but less stimulative in '22³

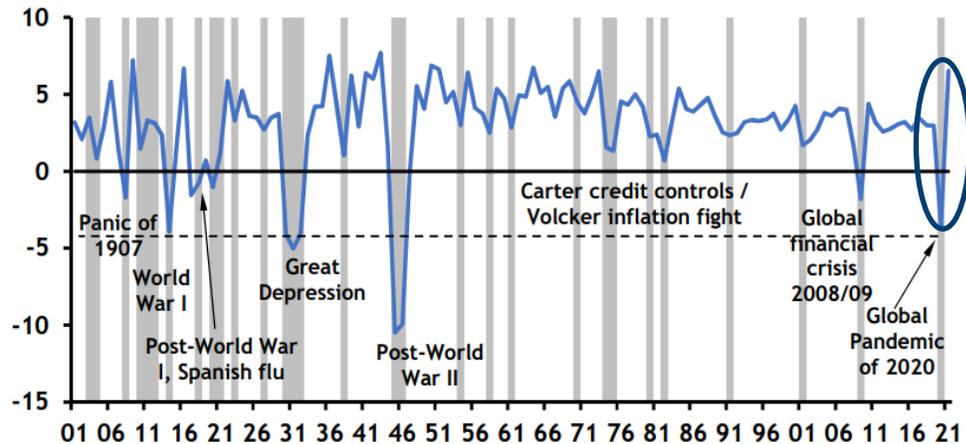
| | Expected Real GDP Growth | | |
|------|--------------------------|--------------------|--------------------|
| | Global | DMs | EMs |
| 2020 | -3.3 | -5.0 | -1.9 |
| 2021 | 6.5 6.2 | 5.6 5.5 | 7.2 6.8 |
| 2022 | 4.5 4.6 | 4.0 4.3 | 5.0 |

1. Factors in place for robust growth include: post vaccination re-openings, accommodative monetary and fiscal policies, pent-up demand, high saving rates, limited scarring effects from recession, and tight inventories
2. EM-DM growth differential expected to average ~1% pt. over cyclical horizon vs. ~3% - pt. in period before pandemic
3. Fiscal policy is expected to be less stimulative in 2022 - - i.e., world fiscal deficits are projected to narrow by ~2.5%-pt. of GDP, while policy rates in major DMs are expected to remain close to zero, though some central banks may start to taper their QE progress

Global Cyclical Outlook (2021 and 2022) – cont'd

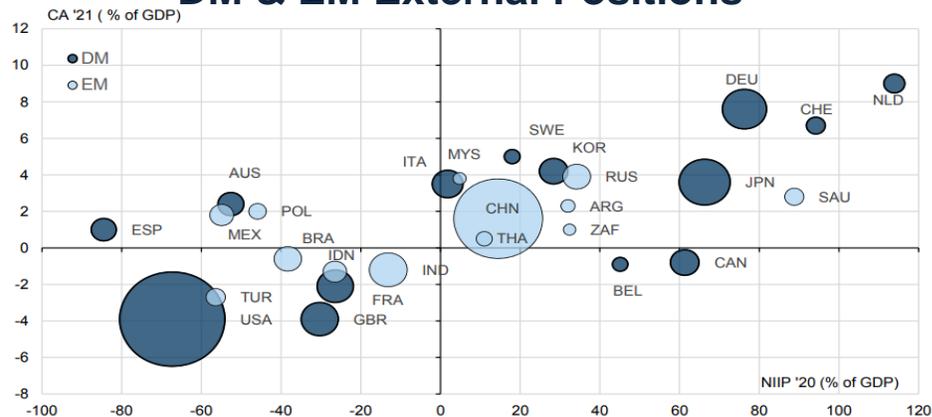
Global GDP Annual Growth Rates: 120+ Yrs. of History

%yoy; US recession bars shown in grey (2021 forecast)



- 2020 recession deepest and shortest global downturn since WW2
- Unprecedented policy response and limited scarring underpin robust recovery

DM & EM External Positions¹



- External imbalances both positive and negative concentrated in DMs (dark blue ovals)
- US and UK: large persistent deficits, major Euro area countries largely positive
- EMs external positions (light blue ovals) largely improved vis-à-vis prior to GFC

1. CA '21 = current account in 2021 (% of GDP), NIIP – Net interstation investment position in 2020 (% of GDP)

Source: JPM, IMF, GS

Inflation Risks

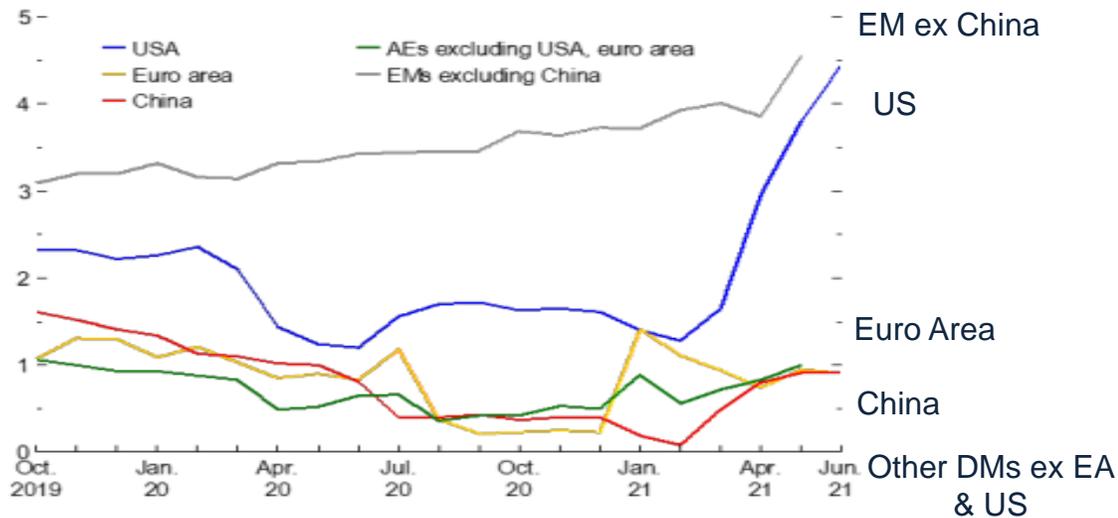
Global Inflation: Current Backdrop

Significant Price Pressures Accompanying Re-openings

- Inflation up from pandemic lows across the world
- Pressures particularly acute in US and certain EMs

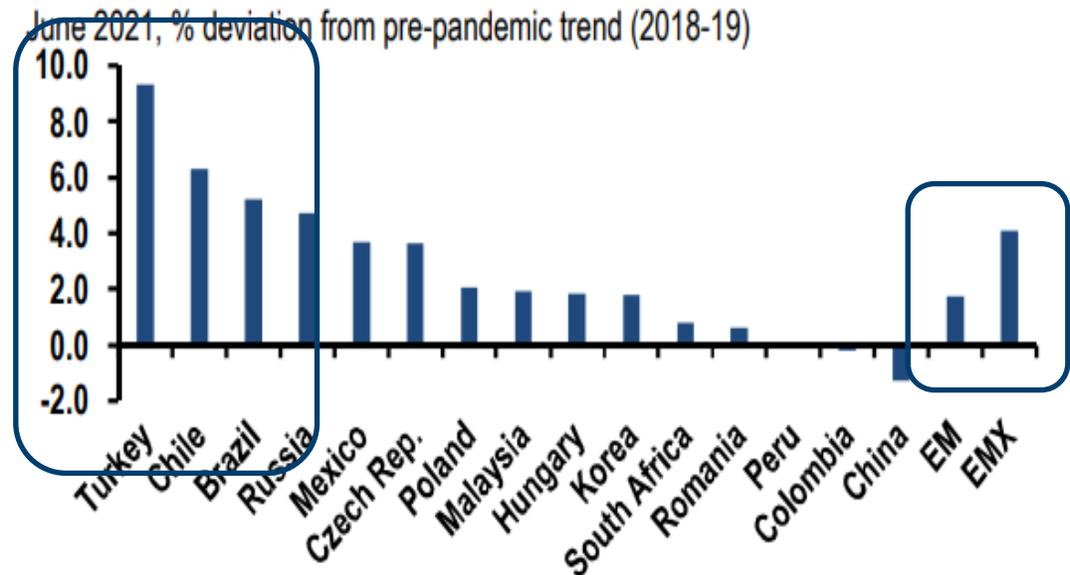
Core Inflation

Key Countries/Regions



Sources: Haver Analytics; and IMF staff calculations.
 Note: AEs = advanced economies; EMs = emerging market economies.

Major EMs



Source: JPM

US Inflation: Current Backdrop

- **Latest Consumer Price Increases Highest in Two Decades**
 - Core CPI 4.5%/Core PCE 3.5% (Fed's target measure)
- **Outsized Increases Concentrated in Few Sectors**
 - Supply constrained categories contributed 120 bps. to jump in PCE
 - Latest used-car auction data and delivery times suggest partial relief by YE¹
 - Hotel prices and airfares up substantially over past few months
 - ~35%-pt. drop from pre-pandemic level largely retraced but prices still 5%-pt. below prior peak
 - Trimmed inflation indexes: Dallas Fed's PCE (1.95%) and Cleveland Fed's CPI (2.90%) over year ago
- **Inflation Expectations Still Appear To Be Contained**
 - Fed's Index of Common Inflation Expectations ~2%²
 - Up from pandemic lows but moderate in context of 20-year history
 - Market and consumer-based expectation concerns primarily focused on 1-year outlook
 - 25% probability of >3% **Headline CPI** over next 5-years imbedded in expectations, however³

1. GS economists estimate that upward pressures from supply-constraint categories will recede to 60 bps by year-end.

2. Composite measure of 22 different market and survey indicators

3. Market pricing current implies a 33% chance of headline in CPI exceeding 3% over next 5 years. It should be noted, however, that CPI generally runs 40 bps above PCE and read above core and currently headline yoy CPI is nearly 2pp above core PCE.

US Inflation: Current Backdrop...cont'd

- **Leading Indicators of Shelter Prices and Wages Could be Signaling More Persistent Price Pressures**
 - Latest reading for PCE shelter component +2% yoy but leading indicator up 3.8% last month¹
 - Wages ex leisure and hospitality still contained but ...
 - Will workers reenter labor force as extraordinary benefits expire?²
 - Will pandemic's productivity lift persist?

1. GS index of four alternative rent measures pointing to significant upward pressures + 3.8% in latest month

2. By early September GS analysts expect 3.5 million workers to lose their \$300 weekly federal top-up, and over 5 million workers to lose their Pandemic Emergency Unemployment Compensation (PEUC) entirely and nearly 6 million to lose their Pandemic Unemployment Assistance (PUA) program benefits.

US Inflation: Current Backdrop

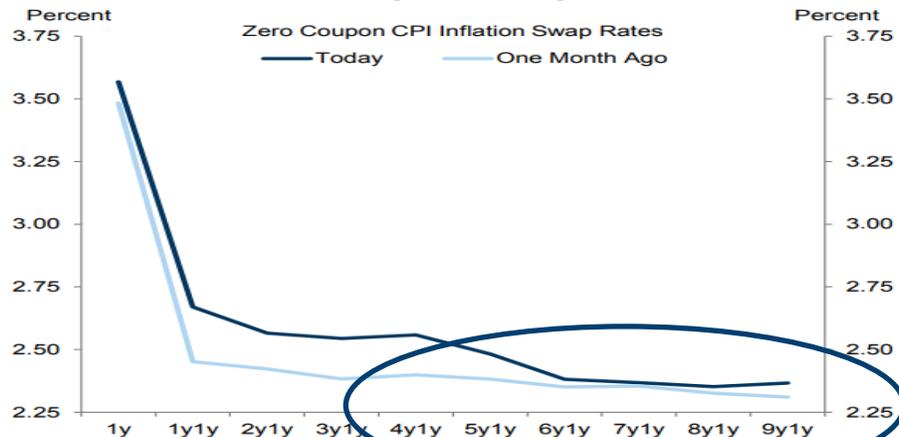
Inflation Expectation



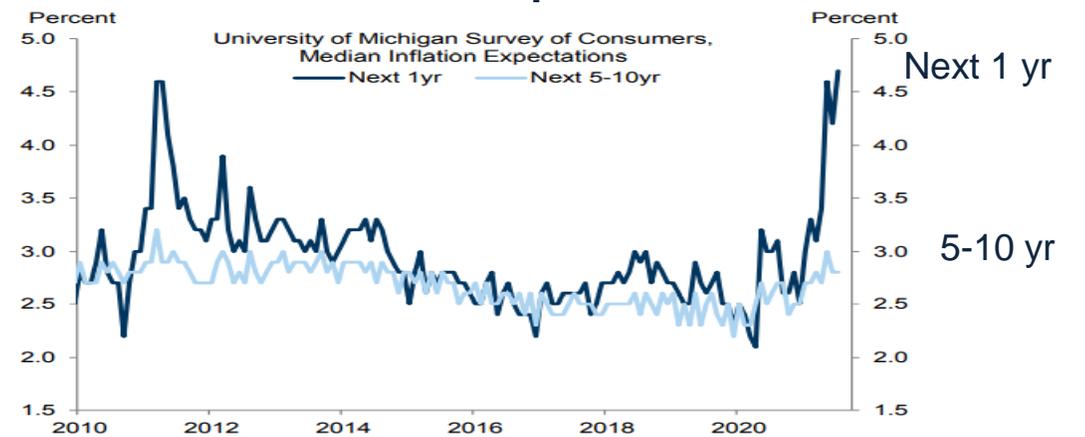
- Fed’s “Index of Common Inflation Expectations” is up from pandemic trough but below 1990 – ~2015 levels
- Comprehensive measure summarizes co-movement of wide variety of inflation expectation measures based on dynamic factor model

Expectations for Year-Ahead Elevated but Contained Over Longer Term

Market Implied Expectations



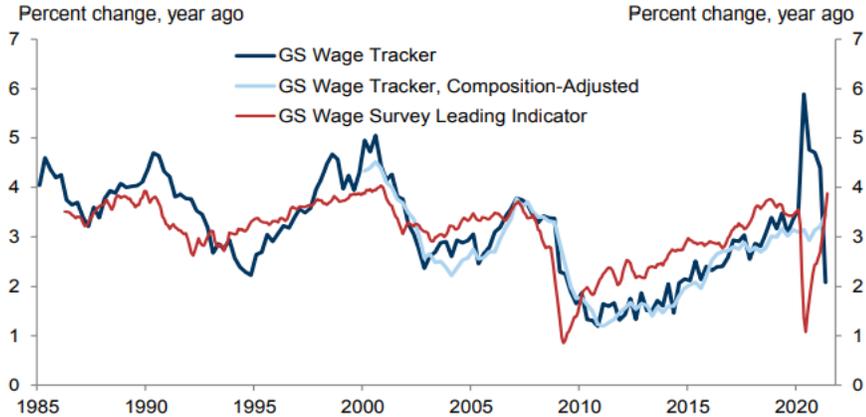
Household Expectations



Source: Fed, GS, Bloomberg, University of Michigan

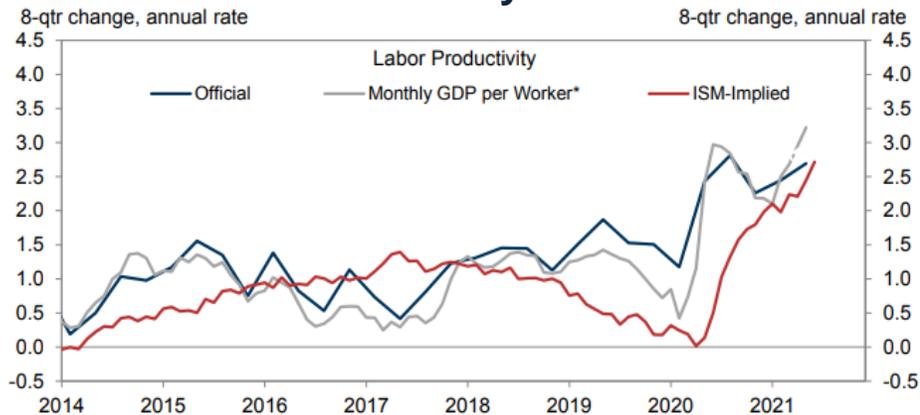
US Inflation: Current Backdrop

Wage Trends



- Wage trends distorted by pandemic effects¹
- Composition-adjusted measure (red line) +3.5% yoy and GS forward indicator +3.9% yoy

Productivity Trends



- Stronger productivity growth could be silver lining of pandemic
- Productivity up at 3.1% annual rate since start of crisis vs. 1.4% in previous cycle
- Efficiency improvements from digitalization continued in Q1 despite partial reopening

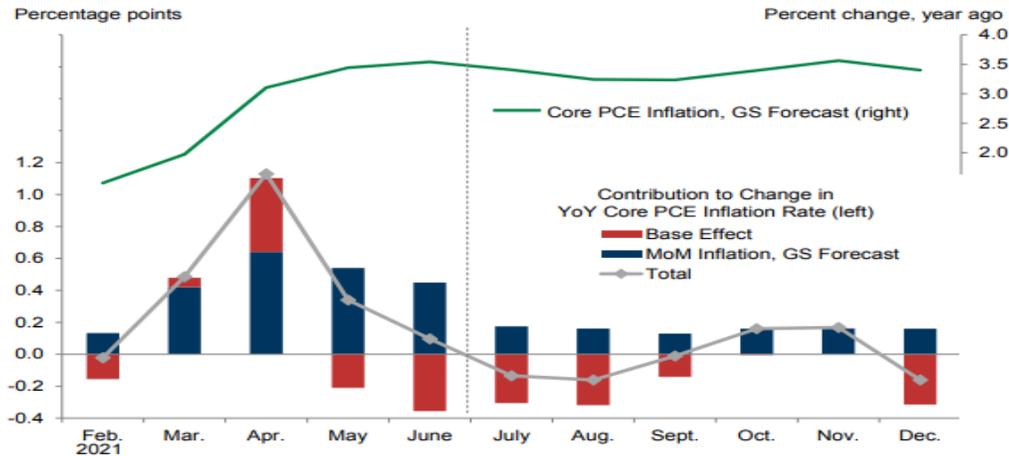
*Three-month centered moving average. Reflects household survey employment.
 Note: Official data for 2Q21 reflects GS GDP tracking estimate (+8.5% qoq ar)

1. Initially low-paid employees were laid off and higher-paid employees kept working, lifting average wages. Now many of waiters are being hired back and year- ago comparisons are with period when they were not working.

Source: BLS, Haver Analytics, GS

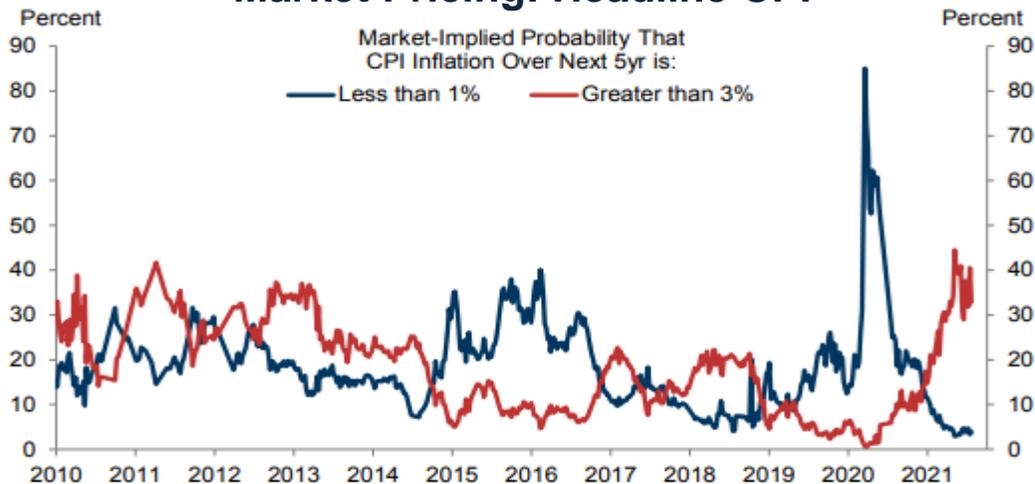
US Inflation: Current Backdrop

Core PCE Forecast/Base Effects



- GS economists project core PCE increases will stabilize at ~3.5% yoy rate for balance of year
- Base-effect headwind (red area in bar graph) imbedded in forecast for 2nd H '21
- Fed's median forecasts for core PCE: 3.4%('21) and 2.1%('22)

Market Pricing: Headline CPI

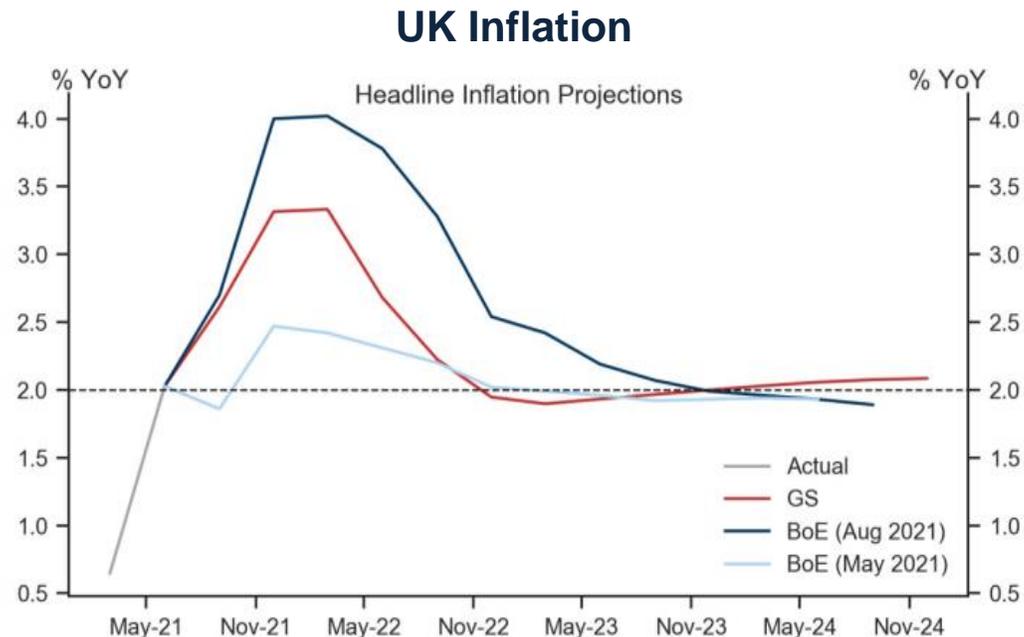


- Current market pricing implies 33% chance of **Headline CPI Inflation** exceeding 3% over the next 5 years --down from recent peak but still high in 10-year historical context

Source: GS, Federal Reserve

UK Inflation: Current Backdrop

- **Recent Jump in Core Inflation to 2.3% yoy from 0.9% in February...**
 - Attributed to reopening pressures: commodity prices, shipping costs, bottlenecks
 - BoE now expects headline inflation to peak at ~4% in Q1 '22 and then recede to 2% in late '23
 - Considerable slack in economy--- should help inflation return to 2% target as near-term effects work out
- **Andrew Bailey¹ Contends Rolling off Fiscal Supports/Return of Current Inactive Workers/and Rotation...**
 - Toward spending on services will help to rebalance demand and reduce bottlenecks
 - Advocates focusing on inflation expectations rather than near-term CPI outturns

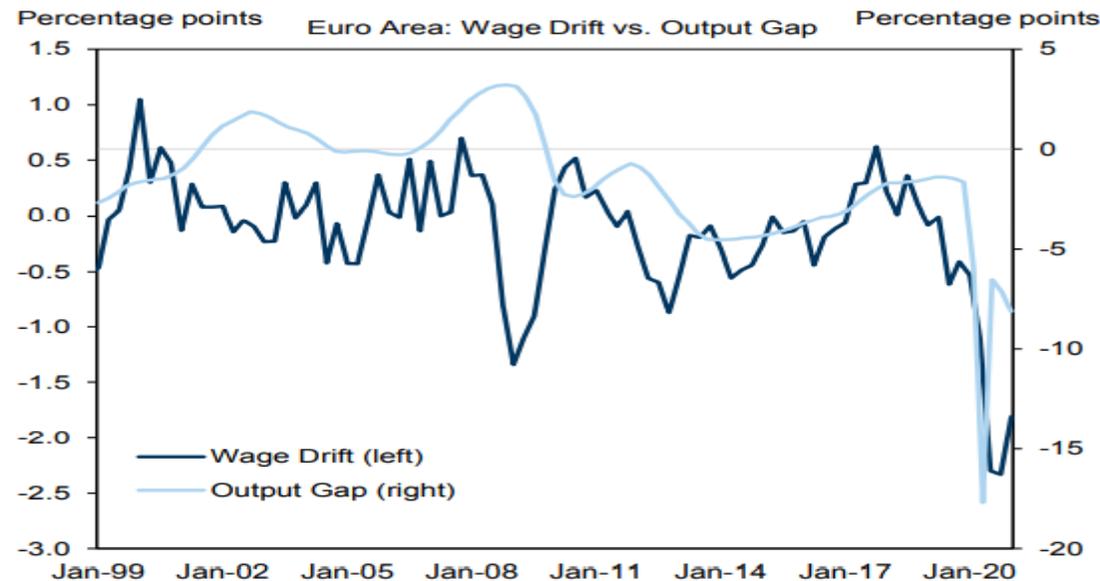


1. BoE governor Bailey's annual Mansion House speech
Source: BoE, GS

Euro Area: Current Inflation Backdrop

- **Core Inflation Expected to Rise From 0.9% (last 3 month) to ~2% Later in Year/Early '22**
 - Reopening effects: higher input prices, catch-up consumer spending and...
 - Tax changes (base of effects Germany's 2020 VAT increase) and technical factors such as HICP weight changes
- **Euro Area Inflation Expected to Drop Below 2% Target as These Temporary Effects Fade**
 - Still considerable slack in Euro Area/stimulus significantly less than in US/wage pressures subdued
 - Area-wide negotiated wage increases: 2.2% ('19), 1.8% ('20), 1.4% (Q1'21)

Wage Drift¹ and Output Gap



1. Wage drift is defined as the difference between compensation per employee and negotiated wage growth.

Source: Haver Analytics, GS

Summary Thoughts on Inflation Risks

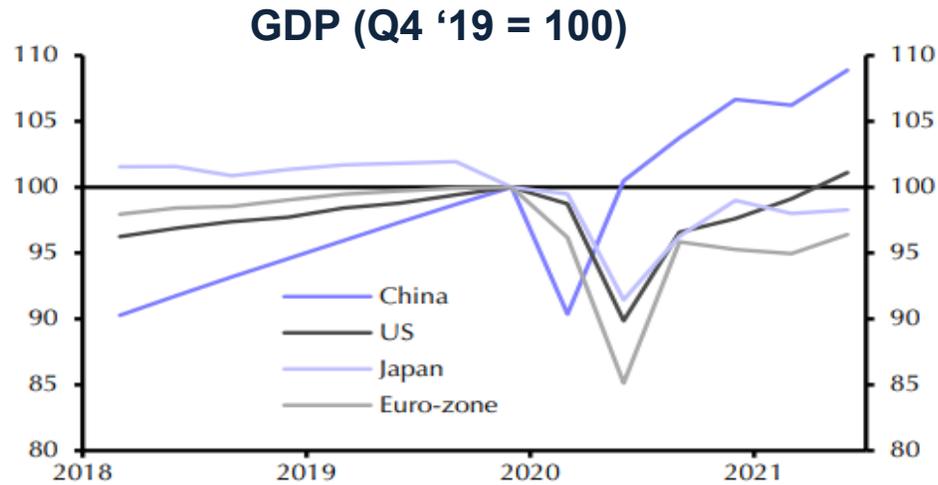
- **Markets Unnerved Thus Far by Greater-Than-Expected ~5% Surge in US inflation**
 - Reopening surges also expected for UK and Euro Area, albeit not as severe as in US
- **Central Bankers(CB) Seemingly Attributing Surges to Transitory Factors and Have...**
 - Modified their policies to accommodate temporary overshoots of targets
- **Inflation Expectations Linchpin in Outlook^{1/} Wages and Shelter Costs Bear Watching But...**
 - As-long-as expectations stay anchored monetary policies should remain accommodative
 - Baseline outlook doesn't point to abrupt change over cyclical horizon, although CBs may start tapping on brakes
- **Concerns of Skeptics Such as Larry Summers Warranted**
 - Fiscal stimulus in uncharted territory and US money growth (M2) at the fastest pace since WW2 but ...
- **Mitigants Could Hold Inflation Expectations in Check, at Least Over the '22-'23 Cyclical Horizon**
 - Covid-related fiscal stimulus expected to slow significantly in '22
 - Saving rates at near record levels with consumers currently saving much of their windfall incomes²
 - US banks can earn interest on their reserves at Fed / Still considerable stack in the global economy
 - Rise in commodity prices, unlike 1970s, should have relatively muted impact on current PCE core inflation³

1. "There is broad agreement that achieving price stability on a sustainable basis requires that long-run inflation expectations be well anchored at the rate of inflation consistent with the price-stability goal." (Richard Clarida)

2. G4 cumulative "excess" savings -- i.e., savings as % of household income since 4Q '19 less 2019 pace -- estimated to reach ~15% by YE. (JPM)

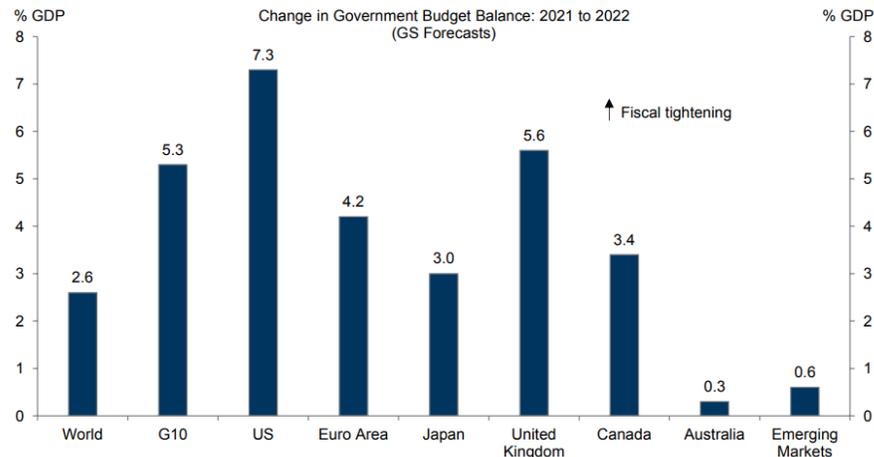
3. Commodity inputs can indirectly affect core inflation, they account for about 3.2% of final consumer prices in the core PCE -- split roughly 60%, 30%, 10% between energy, agriculture and other commodities -- or about 4.9% of the headline index according to GS economists

Summary Thoughts on Inflation Risks



- China only major economy with GDP materially above pre-pandemic level
- US GDP in Q2 of this year retraced to Q4 '19 level but employment still 5.7 million below February 2020
- Other major DMs yet to catch up

Fiscal Deficits to Narrow in '22



- Extraordinary Covid-19 fiscal stimulus expected to contract in '22
- US budget deficit estimated at ~7.5% ~of GDP in '22 vs. ~15% of GDP in '21 ---a 7+%pt. decline

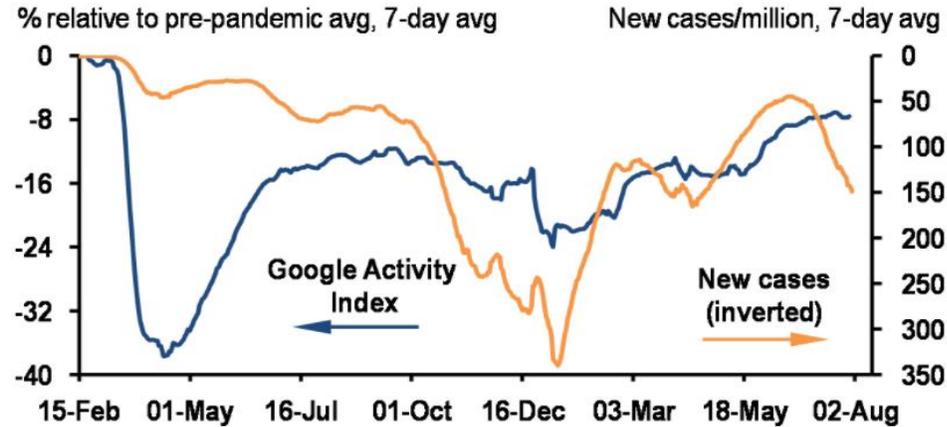
1. GS'2022 US deficit estimate incorporates an assumption of additional fiscal spending of about \$3 trillion over 10 years in connection with the infrastructure and broad social spending packages.

Source: Refinitiv, CE, GS

Virus Risks

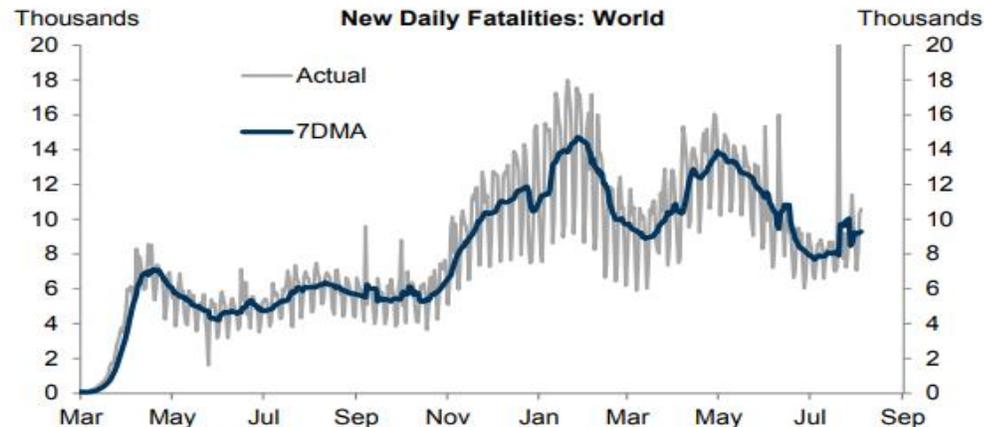
Good & Bad News Related to Virus: Current Backdrop

Global Mobility & New Covid-19 Cases Per Million



- The “good news” and the “bad news” of the current virus backdrop reflected on this chart
- New global cases are rising once again (gold line) but...
- Global mobility -- supported by vaccinations, less stringent lockdowns and improving medical knowledge - - is remaining near pre-pandemic levels (blue line)

New Daily Fatalities¹



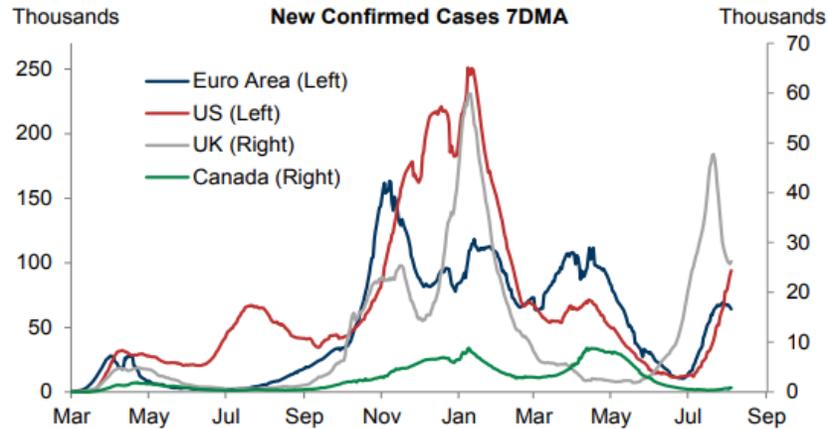
- Global fatalities remaining below recent peak levels is no doubt helping to sustain mobility and supporting economic activity

1. Recent spike in fatalities in early July due to reporting anomaly. Ecuador which reports infrequently, and India reported an upward revision in their fatalities on the same day

Source: Google, Our World In Data, JPM, JHU, GS

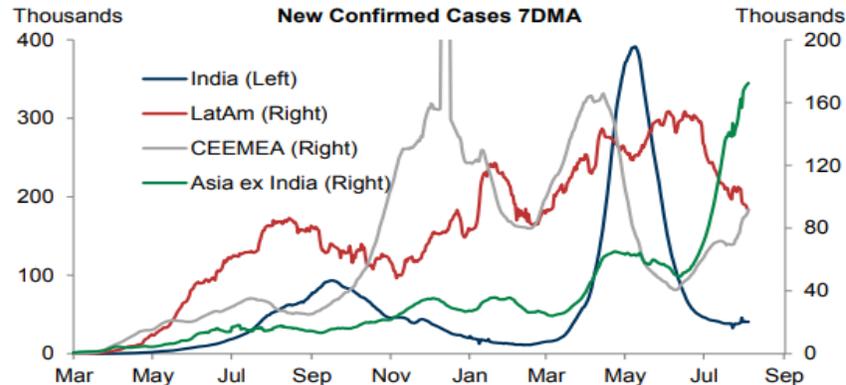
Disparate Country/Regional Virus Trends: Current Backdrop

Major DM Countries/Region: New Cases



- Cases in UK (gray line) - - first major Western country to experience significant wave of Delta variant - - declining sharply¹
- New cases still rising in US but appear to be topping in Europe, while declining in some Euro area countries and in some US states²

Major EM Region/India/New Cases



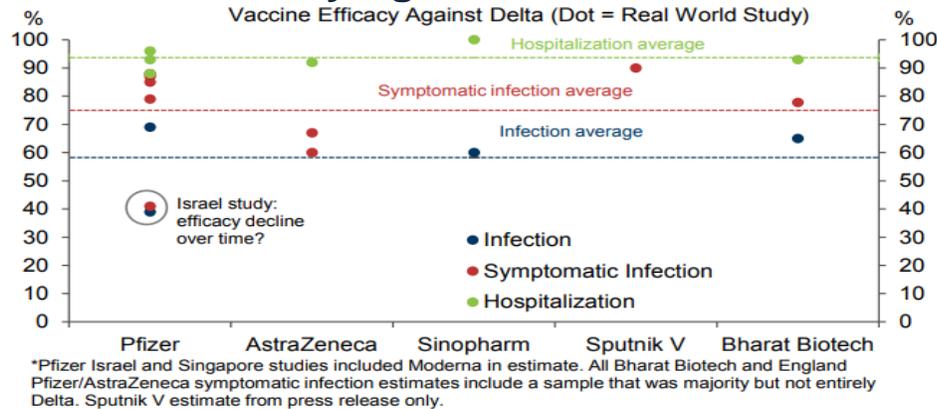
- New cases in India (blue line) and Latin America (red line) are down significantly from recent peaks
- In contrast, new cases are rising sharply in Asia ex India (green line) e.g., Indonesia, Malaysia and Thailand

1. The recent decline UK cases coinciding with the reopening is a promising sign, but epidemiologists can't fully explain the causes. Some partial explanations included end of soccer (football) tournament, start of school holidays and summer weather.
2. Recently new cases have started to decline in Portugal, Italy, Spain and the Netherlands, despite restrictions being mostly if not entirely lifted. Similarly, in the US in states such as Missouri, Arkansas and Nevada where the Delta erupted are now seeing some of the slowest growth rates in the US.

Source: JHU, GS

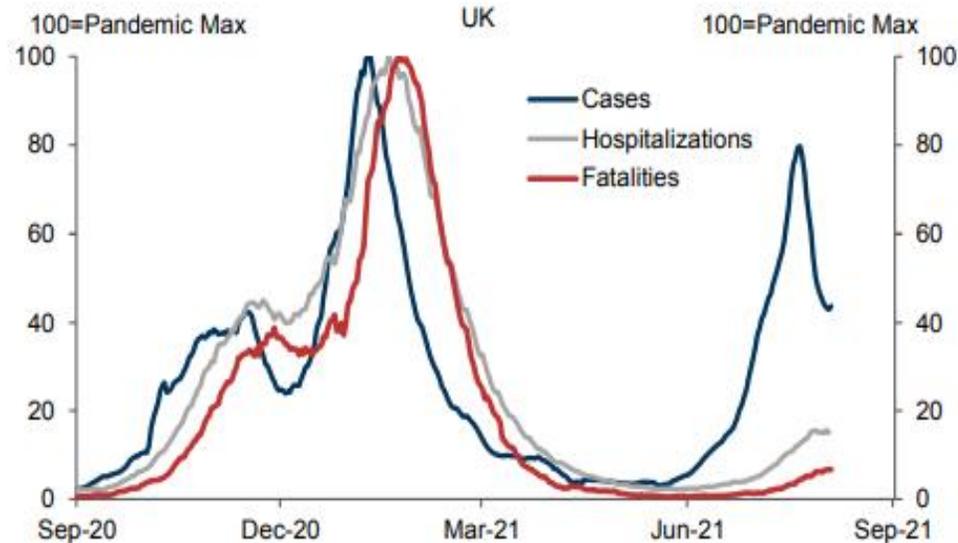
Efficacy of Vaccines: Current Backdrop

Efficacy Against Delta Variant

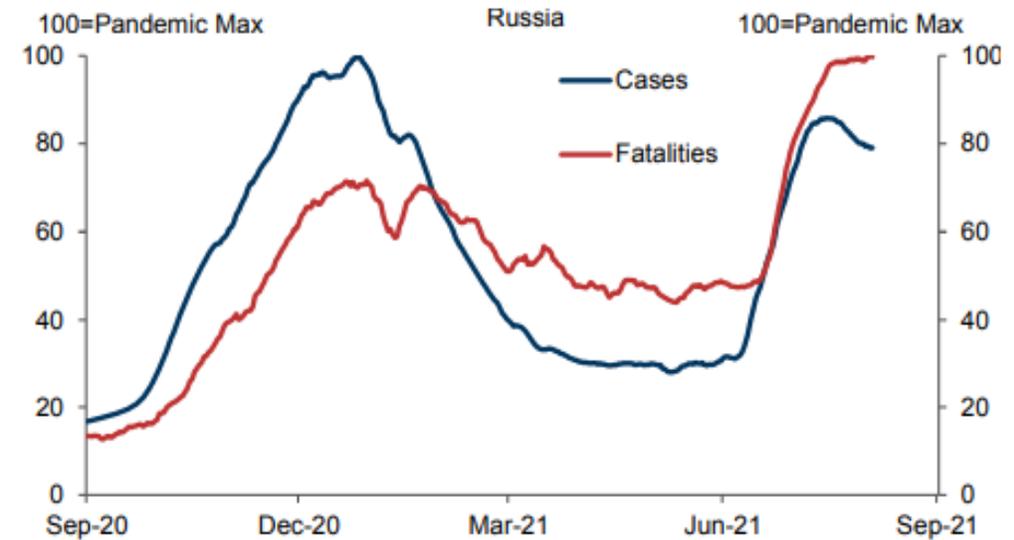


- Efficacy of vaccines to prevent hospitalizations ~90%
- Pfizer and BioNTech efficacy in preventing infection declines after 6 months but preventing serious illness remains higher

High Vaccination Rate/Low Fatalities¹



Low Vaccination Rate/High Fatalities

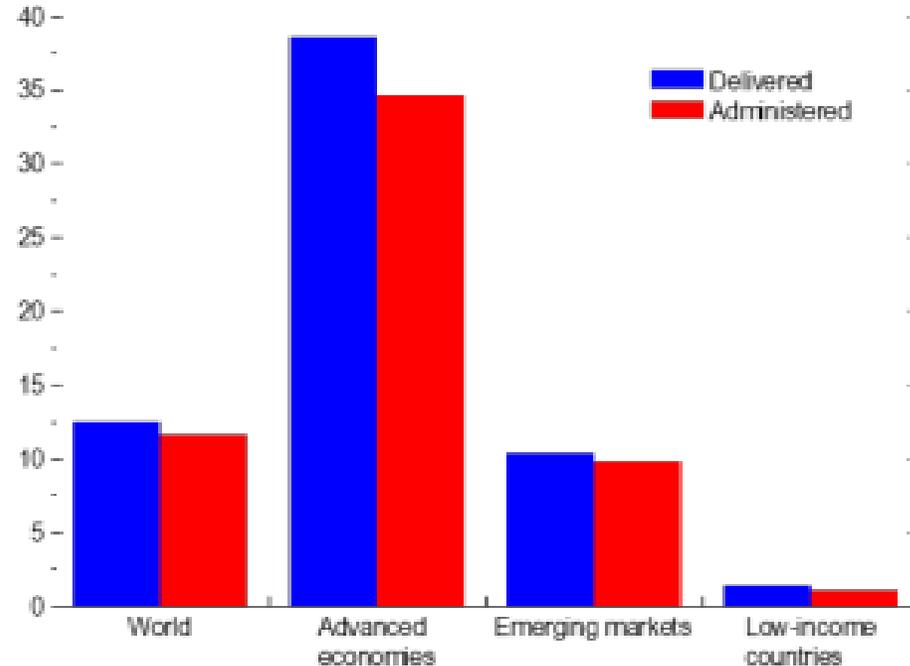


1. 1. the share population that have received first dose: 69% (UK) vs ~25% (Russia) and re second dose 60% (UK) vs ~15% (Russia)

Source: Our World In Data, JPM

Vaccinations Important Lever in IMF's GDP Forecast: Current Backdrop

Figure 1. Vaccine Courses
(Percent of population)



Sources: Airfinity; and IMF staff calculations.

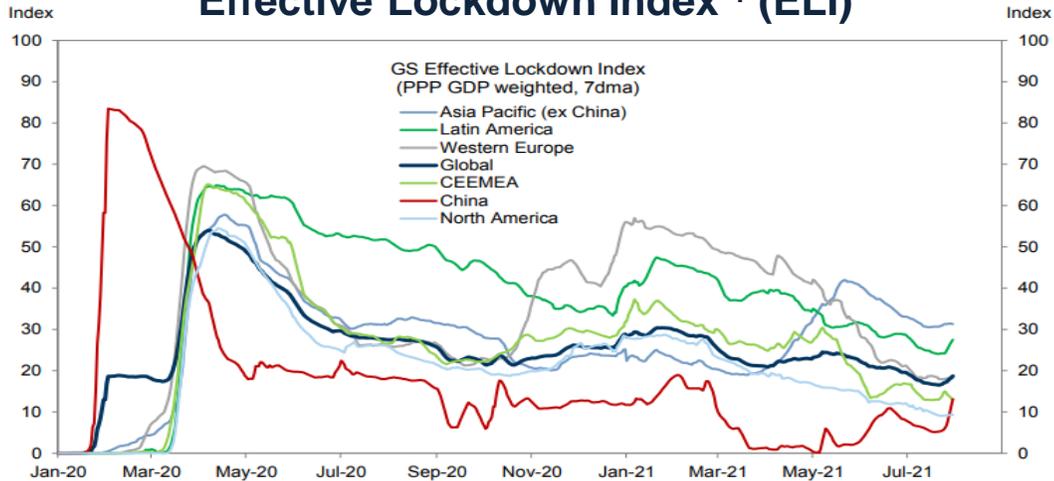
Note: Latest data available are for July 6, 2021. Bars show the ratio of vaccine courses needed for full vaccination (two doses generally, but one dose for Johnson & Johnson and CanSino) either delivered or administered to population by WEO economy group.

- IMF in recent update of their global GDP outlook characterized vaccinations as the “principal fault line”
- Forecast for '21 global growth unchanged at 6% but DM growth raised (+0.5%-pt.) and EM growth reduced (-0.4%-pt.)¹

1. The IMF's July update of their '21 outlook left forecast global growth at 6% but raised the outlook for advanced countries by 0.5%-pt to 5.6% and lowered the outlook for EM&DE by 0.4%-pt to 6.3%

Virus Effects Continuing Economic Headwind: Current Backdrop

Effective Lockdown Index ¹ (ELI)



Source: Oxford University, Google, GS

- Global ELI (blue line) currently slightly below 20 vs a pandemic peak of ~55
- Stricter movement restrictions being imposed in China (red line)

Asia Pacific: Lockdowns/Delivery Times



Note: We invert the PMI data so that larger values correspond to longer supplier delivery times.

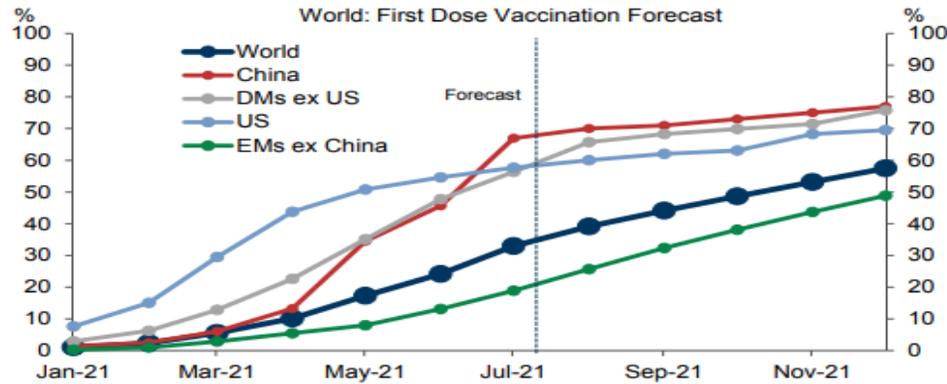
- Surge in cases in Asia Pacific region since April is increasing shutdowns and delivery times from Indonesia, Australia and Vietnam
- If new restrictions are required that constrain semiconductor production and/or key imports from China, this could further disrupt supply chains and increase bottlenecks

1. Combination of official restrictions and active mobility data from 46 economies weighted by PPP GDP

Source: Oxford University, Google, GS, Markit

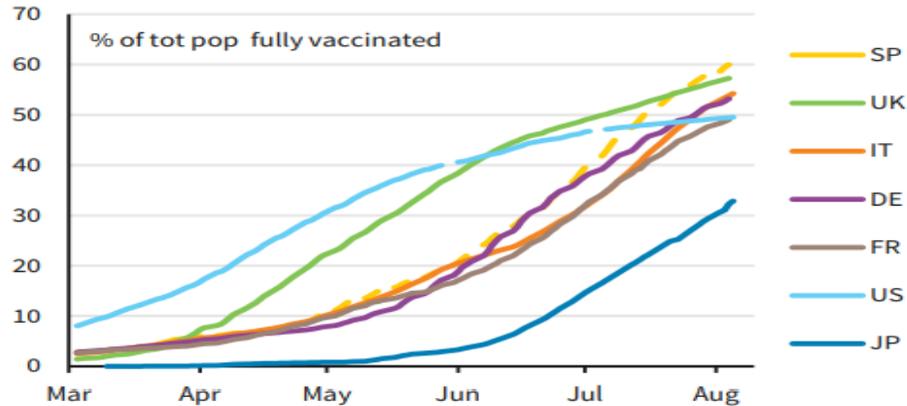
Significant Ongoing-Vaccination Progress: Current Backdrop

World: Major Countries/Groupings



- Share of world population that has received a first shot is expected to reach 60% by YE
- DMs and China will continue to lead the less-developed countries but 50% of the population of EMs ex China are expected to receive first doses by YE

Major DM Economies



- Across major DMs (ex Japan) between ~50% and ~60% of the populations are fully vaccinated

Source: Our World in Data, GS, Oxford University, Haver Analytics

Summary Thoughts Re Virus and Vaccines

- **Delta Variant Propelling Latest Global Wave of New Cases**
 - Global mobility largely unaffected thus far/still slightly below pre-pandemic levels
 - Fatalities considerably below recent peaks
- **Vaccinations Important Antidote**
 - 90% effective in preventing hospitalizations and severe illness
 - Direct link between a country's health and economic prospects and its vaccination rate
- **Making Significant, but Uneven, Progress in Vaccinating the World**
 - 70%-80% of populations of DMs and China expected to receive 1st dose by YE
 - 50% of EM population expected to receive 1st dose by YE, up from ~25% currently
- **Global Lockdowns on Downward Trend but Still Economic Headwinds**
 - Risk further restrictions being imposed in Asia Pacific region that exacerbate bottlenecks
- **Ebb and Flow of World's New Cases Underscore Much to be Learned re Covid's Pathology**
 - Recent sudden declines in UK, India and in some Euro area countries and US states not fully explained
 - Correspondingly, no clear-cut explanation for recent surge in Asia Pacific region
- **Fortunately, We're Learning to Protect Against Worse Outcomes and to Reduce Chance of Infection**
 - Agree with skeptic who contends -- unlikely we'll eliminate the virus / need to learn to live with it¹

1. Jay Bhattacharya, professor of medicine at Stanford noted that unlike smallpox which is the only virus eliminated SARS-Covid is carried by humans and animals and would be very difficult to eliminate

Concluding Thoughts

Concluding Thoughts

- **Three Interrelated Macro Factors that Bear Watching¹**
 - Unfolding expectations for continuing robust global expansion
 - Evidence that inflationary-reopening surge is, indeed, transitory
 - Course of virus and vaccinations
- **Global Cyclical Outlook**
 - Arrows well aligned for strong cyclical recovery over balance of '21-'22
- **Inflation Expectations Still Well Anchored but Need to Remain So**
 - Reopening-price pressures expected to abate as recovery progresses
 - Central bankers need to maintain balanced posture
 - Start to tap on brakes before economies overheat and...
 - Avoid acting too forcefully and/or prematurely
- **Virus and Vaccination Progress Largely Reassuring but Questions Remain**
 - Recent ebb and flow of new cases underscore that pathology of virus not fully understood
 - Appears that we'll have to continue learning how to live with the virus

1. The macro three factors - - strength of expansion, inflation risk, and course of virus and vaccinations - - are interrelated but in an attempt at improving clarity of our discussion, I'm treating them separately

Appendix

Selected Country/Regional Forecasts

| | GDP Growth % | | |
|------------------|--------------|---------------------|--------------------|
| <u>Major DMs</u> | <u>2020</u> | <u>2021</u> | <u>2022</u> |
| US | -3.4 | 6.5 6.1 | 4.0 4.1 |
| Euro Area | -6.5 | 4.5 5.2 | 4.3 4.6 |
| UK | -9.8 | 7.0 | 5.0 |
| Japan | -4.7 | 2.9 2.6 | 2.5 3.7 |
| <u>Major EMs</u> | | | |
| China | 2.3 | 8.7 8.3 | 5.6 |
| India | -7.0 | 10.5 9.0 | 7.0 7.5 |
| Brazil | -4.1 | 3.2 5.0 | 2.5 |
| Russia | -3.0 | 3.5 3.7 | 3.0 |

Source: SECOR Forecasts

2021

- Euro Area : Outlook revised up since April, economy gaining momentum from re-openings
- US: Continuing to benefit from unprecedented stimulus but growth expectations pared back slightly due to bottlenecks and shortages
- UK: Consumption enjoying rapid rebound with re-openings, outlook unchanged
- China: strong growth still expected for full year, slight reduction since April reflects recent virus resurgence and some sector-level regulatory tightening
- India: Strong rebound still expected for fall year, despite virus-related weakness in Q2

2022

- Aside from few minor tweaks, year-ahead outlooks unchanged

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