Monthly Macro Insights

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Rothschild & Co
Asset Management

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Recent additional fiscal support – especially in the US – on top of an already unprecedented package of measures, has once again uplifted the growth outlook. Global business confidence in the manufacturing and service sectors improved in March, reaching a ten-year and three-year high, respectively. Yet, uncertainty remains, primarily related to the path of the pandemic and to the impact of the divergences that have developed across and within countries.

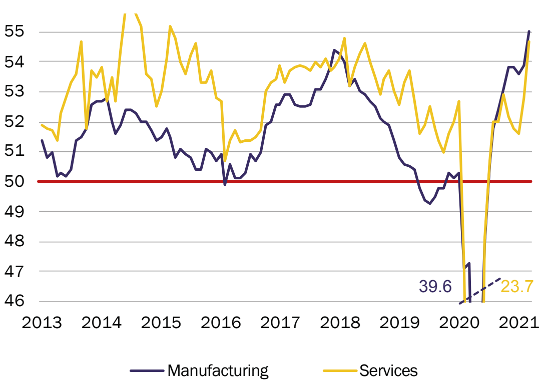
A way out of the health and economic crisis is increasingly visible as vaccines that can reduce the severity and frequency of infections are being distributed. That said, during the past few weeks, global Covid-19 infections have been surging in the most synchronised fashion since the start of the pandemic. Except in a handful of countries with high vaccination rates, the link between rising mobility and infections has strengthened with the spread of new variants.

Not surprisingly, the vaccine industry is facing major challenges, including input supply bottlenecks. Vaccine access is also iniquitous with high-income countries, representing around 15% of the world's population, having pre-purchased 50% of the doses. The World Health Organization has delivered a stark warning of the risk governments are taking by failing to ensure all countries have sufficient access to vaccines. In fact, the more the virus circulates, the more likely it is that mutations and variants will emerge to the extent that the majority of first-generation vaccines could be rendered ineffective and new or modified vaccines are required.

Yet, investors seem convinced the risk that the global economic rebound will be thrown off course is small given US policy supports and the expected rapid pickup in vaccine production.

In the US, severe weather depressed activity in February and the drop in new home sales (-18.2%), housing starts (-10.3%), retail sales (-3.5%) and industrial production (-2.2%) were much deeper than expected.

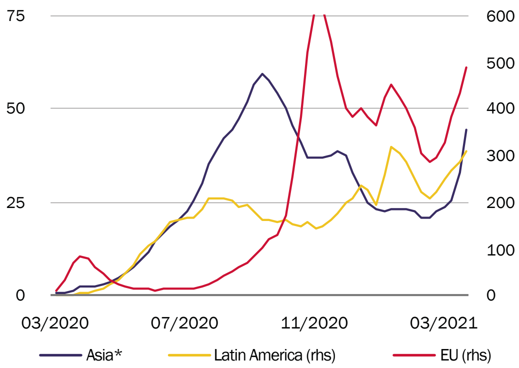
World - Business confidence index



Source : Macrobond, Rothschild & Co Asset Management Europe, April 2021

World - Covid-19 new cases

per 100 000 inhabitants, 14 days



**ex China/Japan*

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

However, data for March and April are expected to rebound strongly and benefit from weather's normalisation, the early stages of help for US households – the USD1,400 cheques – coming from the USD1.9tn American Rescue Plan, and the vaccine distribution that is allowing "reopenings".

Indeed, business surveys firmed in March, including the ISM[1] non-manufacturing activity index which reached the highest level in the survey's history (1997) while the ISM manufacturing hit a peak since the 1980s. US businesses are confident the lifting of Covid-19 pandemic-related restrictions will release pent-up demand, although material shortages and challenges in logistics and human resources continue to cause supply chain disruption.

What's more, President Biden unveiled his proposed infrastructure package, calling for about USD2tn in spending that would in part be financed through higher taxes on businesses and upper-class income households. While Republicans are unlikely to support a plan with significant funding for green initiatives and tax increases, Democrats might be able to coalesce around a plan, although it may require months of negotiation and could thus result in a trimming in size, that will likely need to pass through the budget reconciliation process.

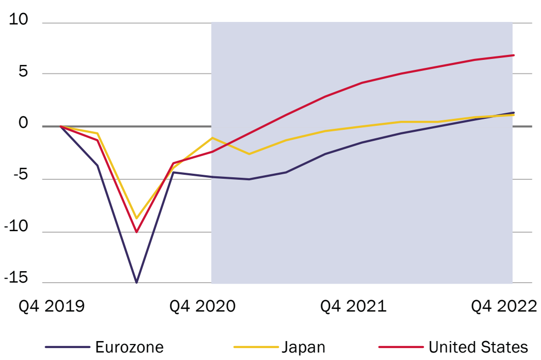
The significant role of the US in the world economy would suggest that the recent upward revisions in its growth outlook – the IMF and the OECD expect 6.4% and 6.5% respectively in 2021 – could have a substantial impact on other countries. Most obviously, trade linkages imply higher US growth would contribute to a rise in its import demand, ensuing directly in an increase in the exports of its trading partners. In addition, the positive developments could have a significant impact on business and consumer confidence abroad and this positive feedback loop could spur consumption and investment globally.

That said, estimating the impact of US stimulus' spillovers is not straightforward. With the US economy opening up a sizable growth differential with the rest of the world, a key risk is also that the dollar strengthens further, thereby straining capital flows into emerging countries (EM). What's more, exports in several EM are mostly invoiced in USD, and its appreciation represents a blow to competitiveness. In addition, private sector USD-denominated debt in many EM has increased markedly in the past decade, rendering the debt service ratios much more sensitive to USD's fluctuations.

The interest rates channel is also of the utmost importance. In recent months, long-term interest rates rose in the US. Assuming such increases are orderly and reflect mainly stronger growth expectations, rather than revised market expectations of the pace at which the Federal Reserve (Fed) will normalise policy, these increases should not pose difficulties for the US economy. In fact, the minutes of the Fed's March meeting reflected the widely held view within the FOMC that the sell-off in bonds is not a source of concern,

World - Real GDP

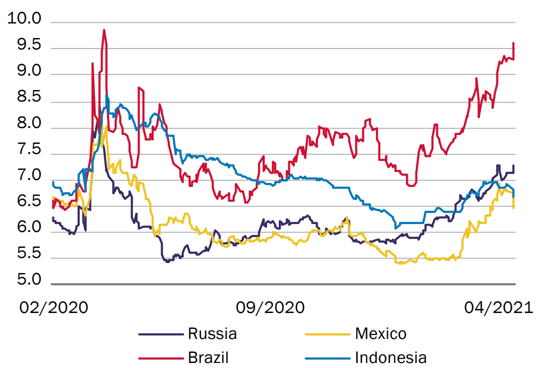
% difference from pre-pandemic levels



Source: OECD, Rothschild & Co Asset Management Europe, April 2021.

EM - 10Y sovereign bond

in %



Source: Macrobond, Rothschild & Co Asset Management Euope, April 2021.

(1) Indicator reflecting the confidence of purchasing managers in a sector of activity. Above 50, it expresses an expansion of activity, below 50, a contraction.

with the Committee agreeing that financial conditions are very accommodative.

However, the contagion to interest rates in other countries could prove problematic. At its last policy meeting, the ECB committed to a significant increase in its pandemic emergency purchase programme (PEPP) purchases for three months, seeking to thwart the rise in yields and signalling its strong commitment to maintaining favourable financing conditions. Yet, most countries don't have this capacity to intervein as promptly and higher US rates could be adverse spillovers to EM, particularly among those with high debt and large financing needs.

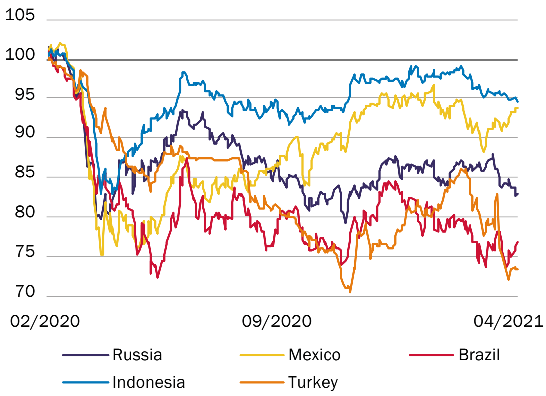
The interdependence with China could also prove challenging for many EM countries. Last year, China had recovered more rapidly than other countries, but at the cost of a further build up in vulnerabilities. In early April, authorities have asked lenders to rein in their credit supply, as the surge of lending that sustained the country's debt-fuelled coronavirus recovery renewed concerns about asset bubbles and financial stability. The move further underscores the shift in Chinese policy away from boosting growth and towards controlling credit risks. Consequently, while China was a key global demand engine last year, it is now downshifting.

Overall, despite still subdued mobility, adaptation to the pandemic has led to a stronger-than-anticipated rebound of activity. Looking ahead, the world economic outlook will depend on the path of the vaccination campaigns while the divergent recoveries could create significantly wider gaps in living standards across and within countries. ■

Completed writing on 8 April 2021

EM - Exchange rate vs USD

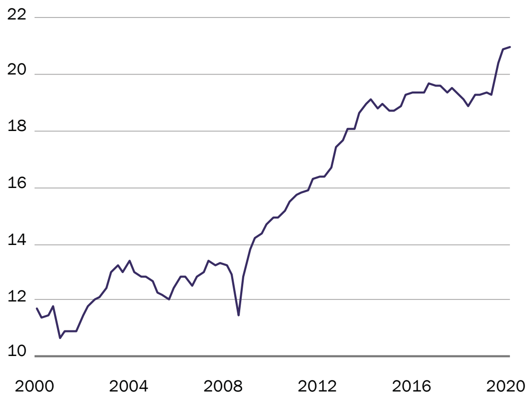
February 2020 = 100



Source: Macrobond, Rotschild & Co Asset Management Europe, April 2021.

China - Debt service ratio

in % of disposable income, private non-financial sector



Source: Macrobond, Rotschild & Co Asset Management Europe, April 2021.

Performance of the indices and interest rate levels

	Price as of 31/03/2021	1 month % change	2021 % change
Equity markets			
CAC 40	6 067	6.4%	9.3%
Euro Stoxx 50	3 919	7.8%	10.3%
S&P 500	3 973	4.2%	5.8%
Nikkei 225	29 179	0.7%	6.3%
Currencies			
EUR/USD	1.17	-2.9%	-4.0%
EUR/JPY	129.86	0.9%	2.9%

		Price as of 31/03/2021	1 month bp(1)	2021 bp
Interest rates				
3 M	Eurozone	-0.62%	-3	14
3 M	United States	0.02%	-2	-4
10 Y	Eurozone	-0.29%	-3	28
10 Y	United States	1.74%	34	83

(1) Basis point.
Source: Bloomberg, data as of 31/03/2021. Performances in local currency.
Past performance is not a reliable indicator of future performance and is not constant over time.

About Rothschild & Co Asset Management Europe
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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