Economic update

Second quarter 2021

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Key points

- The Covid-19 pandemic continues to ravage the globe, with India being the current epicentre. But the picture is uneven, and the availability and deployment of vaccines has enabled last autumn's economic recovery to gather strength. Many of our growth forecasts have therefore been upgraded.

- The strength of recoveries in individual countries will depend on how bad things were in 2020, the speed at which vaccines are rolled out, and the extent to which households have been able to build up savings during periods of lockdown. A slow start to vaccinations will delay recoveries in the EU and Japan, while lower levels of government support will inhibit the revival of consumer spending in many emerging economies.

- The combination of strengthening commodity prices and supply bottlenecks (for shipping containers and semiconductors, for example), is putting upward pressure on prices. These issues should soon abate but, looking further ahead, the powerful stimulus provided by governments, central banks, and enforced savings by households could cause a build-up of inflationary pressures.

- In the UK, where the deployment of vaccines has been relatively swift, the economic recovery has resumed after a pause of six months. With some restrictions eased in England from 12 April, economic activity is expected to expand briskly in the coming months, with GDP growth for 2021 now projected to come in at close to 6%.

- The revival will be fuelled by the enforced savings of households, ongoing (albeit tapering) government support, and buoyant fixed investment spending by businesses. Provided that the easing of restrictions continues as planned, then the risks are on the upside, with GDP growth of 7-8% this year being feasible.

- The new trading arrangements with the EU have proved to be problematic for many exporters and importers, especially those who trade in food, animal, and plant products. Exports are expected to make little or no contribution to the recovery process this year, not only because of the new costs and complexities of trading with the EU, but also because of the muted recoveries in many major markets.

- The Bank of England is not expected to provide any further monetary stimulus, and negative interest rates have been taken off the table. Debate is now focused on whether, and to what extent, quantitative easing should be unwound before Bank Rate is increased. Certainly, interest rates are not expected to be hiked before the end of 2022, and perhaps not for some time thereafter.

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The global economy – the recovery gathers pace

Economic prospects for the coming year, both globally and at national level, will continue to hinge on the success, or otherwise, of individual countries in tackling the Covid-19 pandemic. Although nearly a billion doses of vaccine have been administered globally, the pandemic is far from beaten, as is clear from the fact that the daily infection count has hit a new peak during recent days as the epicenter has moved to India. Injecting enough of the world's population to allow life to return to something like its pre-pandemic norm will take another couple of years; and meanwhile there is the ever-present risk that vaccine-resistant mutations of the virus could emerge, a development that would necessitate the imposition of further restrictions until reformulated vaccines can be deployed.

Nonetheless, every economy will recover to some extent during 2021, with the strength of the revival depending on several factors, including: the scale of the decline in activity last year; the speed and success of vaccine roll-out; and the extent of government support for individuals and businesses. In many countries, the annual GDP growth rates for this year will look pretty impressive, with some advanced economies posting the sort of increases that they haven't seen since the 1970s. But a word of warning to the unwary: these headline growth rates won't always be as good as they seem, especially in cases where output fell very steeply in the first half of last year.

Apparently-strong annual growth rates may also hide considerable variation from one quarter to another, or between various sub-national regions. Countries that look to be lagging in the vaccination stakes might quickly catch up, especially if they're small, while others who've got off to a strong start might flag before they reach the finish line, especially if they start to encounter hesitancy in younger age groups. Meanwhile, countries that have experienced a relatively low rate of infections have tended not to be the front-runners in getting their populations vaccinated. But although their domestic economies may have remained more or less open during the pandemic, they may continue to feel negative impacts for an extended period, especially if international tourism is important for their economies. This is the case for Australia, New Zealand, and Taiwan, which have succeeded in stamping out their Covid outbreaks, but find themselves unable to lift travel restrictions because of low vaccination rates.

Notwithstanding these caveats, it's heartening to report that prospects for the world's major economies have improved since the start of this year, with most forecasters, including HSBC, revising their figures higher. HSBC now expects that, after a contraction of 3.5% in 2020, the global economy will rebound by 5.6% this year, and by a little over 4% in 2022. This compares with our previous forecasts, back in January, of 4.8% and 3.3% respectively.

Global growth rates: HSBC forecast, compared to our previous (December 2020) forecast

% change in GDP, vs previous year

	2020	Forecast for 2021		Forecast for 2022	
		Current forecast	(Previous forecast)	Current forecast	(Previous forecast)
World	-3.5	5.6	(4.8)	4.1	(3.3)
USA	-3.5	6.0	(3.5)	3.9	(2.5)
China	2.3	8.5	(8.5)	5.6	(5.6)
Japan	-4.8	3.8	(3.2)	1.3	(1.0)
India	-6.9	11.0	(8.3)	5.8	(4.4)
Eurozone	-6.8	3.6	(4.7)	4.0	(2.8)
UK	-9.9	5.8	(4.3)	6.1	(5.0)
Russia	-3.1	3.1	(2.3)	2.9	(1.3)
Brazil	-4.1	3.2	(3.2)	2.3	(2.3)

Source: HSBC Global Research

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The Biden economic stimulus

Our upgraded forecasts reflect not only the success of vaccine deployment in some countries, notably in the USA and the UK, but also the Biden Administration's $1.9 trillion stimulus package for the US economy, which was passed by Congress in March. This aggressive fiscal stimulus will not only produce a major gear shift in the pace of America's economic growth, but will also afford exporting opportunities for businesses in other countries.

But there could be a sting in the tail: with the Federal Reserve committed to letting inflation run above the 2% target for a while, it could also deliver a global inflation shock that might lead to marked exchange rate movements and volatility in financial markets. It's a generation since the developed world last saw much in the way of inflation, so it's hard to know how central banks, governments, and financial markets will respond.

Adapting to Covid restrictions

Most of our country-level forecasts for GDP growth in 2021 have been upgraded since the last Update. This is partly because of the speedy roll-out of vaccines in some countries, but is also partly a recognition of the extent to which businesses and individuals around the world have adjusted their economic lives in response to varying levels of Covid restrictions. Although many countries in the northern hemisphere have spent the winter months with tough lockdowns in place, which have meant many shops and hospitality establishments remaining shuttered, the declines in economic activity have been much smaller, compared to those experienced last spring.

Indeed, the global recovery which got under way last May has just about sustained its momentum during the early months of 2021 – and this despite the new waves of infections that have been more virulent than those experienced during the early months of last year. And meanwhile there has been a marked improvement in business sentiment, with the IHS Markit global composite Purchasing Managers' Index (PMI) rising to 54.8 in March (remember that any reading above 50 represents expansion). This was the best reading from these surveys since 2014, with the widespread strength in manufacturing extending into some of the service sector surveys, notably those in the USA, the UK, and China.

Uneven progress on the vaccination front

But, as has been clear from the wall-to-wall media coverage, the distribution of vaccines has not been proceeding at a uniform pace across the world's major economies. Among smaller countries, Israel and the UAE have led the way and are already enjoying a return to something approaching normal life. Among the larger advanced economies, the early pacesetters have been the United Kingdom and the United States, while progress has been much slower in the EU and in Japan.

The rapid vaccine roll-out in the USA, coupled with the Biden Administration's stimulus programme, means that we now expect the US economy to expand by 6% this year. And with America's economy having experienced a relatively modest contraction of only 3.5% in 2020, it will be one of the few major economies that will be larger in 2021 than it was in 2019. The UK is also expected to notch up growth of close to 6% both this year and next, on the back of having already provided at least one dose of vaccine to three fifths of the adult population, which has helped lower the infection count back to where it was in early September.

The picture across emerging economies is distinctly mixed. A sharp fall in Covid infections in Brazil and India towards the end of last year had fuelled hopes that 'herd immunity' might be within reach in major cities, but those hopes have been disappointed. Both countries are now finding their recoveries dented by a resurgence of infections at a time when their vaccination programmes are still at an early stage. China, meanwhile, has

remained relatively free of the virus, but has seen only a muted recovery in domestic consumption, with its impressive-looking GDP growth rates being powered by strong demand for exports. It's likely, moreover, that the global surge in demand for manufactured goods – which was partly a consequence of lockdowns in western economies – will run out of steam in coming months, as western consumers shift their spending back towards service sector activities like travel, leisure, and restaurants. And even after emerging economies get their populations vaccinated, their household spending probably won't rebound with the same sort of vigour that we're expecting in some advanced economies: this is because governments in lower-income countries have, in general, been less able to provide financial support to households than have their counterparts in higher income countries.

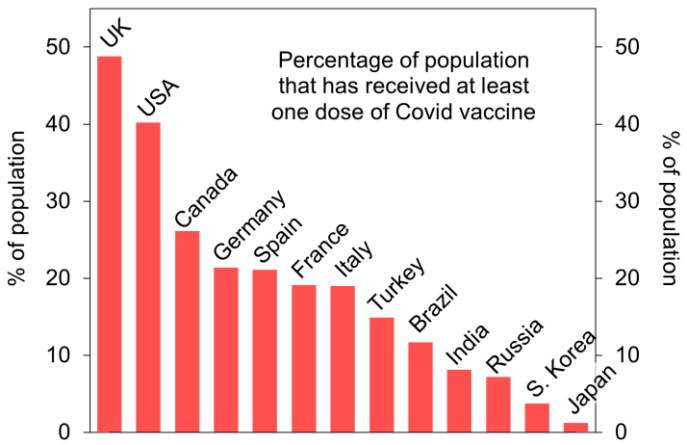
A global savings glut

Estimates of the extra savings run-up by households in the world's major economies during the pandemic are eye-watering, running to more than $3 trillion. The extent to which households have built up such savings will reflect the severity of economic restrictions, and on the level of government support (in the form of short-time work schemes, enhanced social benefits, or other grants). How much of these savings will now be spent on current consumption will be driven, among other things, by the timing and durability of re-opening, by the existing levels of borrowing, and by the ingrained preferences of populations between saving and spending.

Given these uncertainties, economists' forecasts could easily turn out to be wide of the mark (even more so than usual). So, while GDP growth in most advanced economies is expected to be in the range of 3% to 6% this year and next, these growth rates could turn out to be higher if consumers decide to go berserk on partying, holidays, entertainment, or the housing market. By the same token, near-term growth might fall short of this if consumers opt instead to repay existing debt (or avoid running up new debt) or boost their pension funds, any of which might be an equally sensible thing to do with this 'savings windfall'.

By the time that life returns to something like normal, the value of this pent-up spending power across most advanced economies is likely to be in the range from 8% to 12% of GDP. These are huge sums, and the money won't all be spent at once – not least because of the ongoing issues in international travel. But this overhang of savings, residing mostly among the middle-aged and the well-heeled, will be important in shaping consumption trends and debt dynamics in the next decade.

Vaccine nations



Source: Our World in Data

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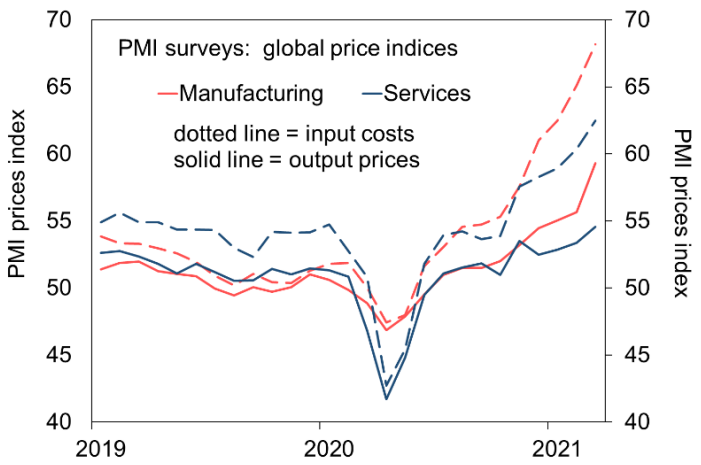
With so much money potentially sloshing around, there are inevitable risks associated with economic and monetary policy in the years ahead. Politicians and central bankers, seared by the travails of the past year, might find it all too easy to sit back and let consumers run amok with their pent-up savings. But, if the result is another spate of bubbles in the residential property market, they might come to regret their complacency. After all, there would be little point in enjoying a rip-roaring boom for a few years, only for it all to go into sharp reverse in the teeth of accelerating inflation and soaring borrowing costs. It has become fashionable to suggest that the world might be in for a repeat of the "roaring 20s": but anyone thinking along those lines should be careful what they wish for – the roaring 20s ended up with the Wall Street Crash of 1929, which tipped the world into a decade of depression and protectionism, from which it only emerged after the Second World War. Whether governments and central banks can be trusted to do the sensible thing is not something that can be taken for granted: as we all know, it's never easy to take away the punch-bowl when everyone is enjoying the party.

Off the floor

In the financial markets, the big story of the past few months has been the uptick in bond yields. The yield on 10-year US Treasuries, for instance, briefly broke above 1.7% at the end of March, having troughed at 0.5% in the first week of last August. Yields are therefore back to where they were in the second half of January 2020, when Covid-19 was just starting to undermine market sentiment. The recent revival has been triggered by the anticipation of a strong post-pandemic recovery and expectations that this will eventually lead to a resurgence of inflation. Given how low the cost of borrowing had fallen during the summer of last year, for many governments, it's something of a mystery that markets have been surprised and unnerved by falling prices for bonds (and hence rising yields). The yields that applied last summer would only have persisted if there had been no prospect of viable Covid vaccines. Meanwhile the world's major economies are receiving massive stimuli, whether from government support schemes, central bank quantitative easing, or pent-up demand by consumers: if all of that can't bring about a revival of inflation, then it's hard to know what will.

There are already plenty of signs of mounting inflationary pressures in global supply chains. Business surveys show input costs rising steeply (and being passed on into output prices), while media reports have been full of stories about ballooning shipping costs, a shortage of containers, and bottlenecks in supplies of semiconductors and speciality chemicals; and all this on top of rising commodity prices. It's therefore no great surprise that annual rates of producer price inflation have now jumped to more than 4% in both the United States and China.

Inflationary pressures in global supply chains



Source: IHS Markit PMI surveys

Inflation risks

There is, however, no guarantee that increases in producer prices will feed quickly through to consumer price inflation. For one thing, firms in many sectors have lost much of their traditional pricing power, with large supermarket chains in particular exerting pressure on manufacturers to absorb increases in costs of materials and ingredients. It's also likely that some of the recent shortages will resolve themselves in coming months, especially as consumers in advanced economies revert to something akin to pre-pandemic spending patterns, while the consumer revivals in many emerging economies will be relatively muted affairs, as discussed above. Nevertheless, while there may not be an imminent risk of inflation taking off in the next year or so, it remains a risk for the medium term if governments and central banks fail to bring the party to an orderly end.

The past few months have seen something of a stand-off between investors and the central banks, with every utterance of policymakers being picked apart for clues as to whether they are going to row back against the recent increase in bond yields or simply let it run. Thus far, the European Central Bank (ECB) has been the only major central bank to push back against the markets, announcing at its policy meeting in March that it would quicken the pace of its asset purchases. But the Bank of England and the Federal Reserve have stood firm, judging that the recent tightening of conditions are entirely warranted by improved economic prospects.

Movements in bond prices obviously affect equity prices. After all, higher bond yields imply a lower valuation for the discounted cashflows of companies. But there's no straightforward relationship between bond and equity prices, especially at the present juncture when share prices which took a beating during the pandemic are now looking more attractive as economies begin to re-open. So while tech stocks have been sold off in recent weeks, equity prices generally remain at elevated levels, with the S&P500 index of leading US shares topping the psychologically-important 4,000 mark for the first time ever on 1 April.

It's also fair to note that there is potential for the mood in financial markets to become volatile. As markets start to contemplate the moment when the major central banks begin to hike interest rates – albeit that this point is still some way off – they're going through a slow motion version of the "taper tantrum" that afflicted them back in 2013. The partygoers all know that the punch bowl must eventually be taken away; that knowledge doesn't make the prospect any more enticing.

Commodities surge, but maybe not for much longer

The prevailing mood of buoyant optimism about the recovery to come has also continued to propel commodity prices higher. The basket of 42 commodities tracked by the IMF was 78% higher in March than it was in April 2020, and some prices are now higher than they were before the pandemic struck. The ongoing strength of China's economy, in particular, has buoyed prices for many of the foodstuffs which the country needs to import in considerable quantities. Pork, fish, soybean oil, and poultry have all seen robust increases in recent months, while the price of wholemilk powder is now some 30% above its pre-pandemic level.

Meanwhile, oil prices briefly touched $70 a barrel for Brent crude in March, but have since fallen back somewhat, with demand prospects dampened by the latest lockdowns in continental Europe. On 1 April, the OPEC+ group, comprising OPEC members and Russia, agreed to unwind some of last year's production cuts: the group's output will increase by 2.1 million barrels a day during May, June, and July, but will then remain some distance below where it was at the start of 2020. The future for commodity prices from here will be more mixed. The recent surge in demand for manufactured products will falter as economies re-open and as consumers re-direct more of their spending towards services. The anticipated appreciation of the dollar, after its recent spell of weakness, will also tend to dampen prices.

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The United States – the Biden Administration gets busy

Following Joe Biden's inauguration as President in January, he has moved swiftly to implement a fiscal stimulus package worth some $1.9 trillion. The package of measures, officially called the American Recovery Plan, was made law in March having gained Congressional approval in fairly smart order. The President doesn't want to stop there, with another ambitious package of measures, worth around $2 trillion over eight years, also in the works. This second package is designed to renew some of America's creaking infrastructure, while kick-starting clean energy investment and tackling issues of social inequality. It will not receive such an easy ride through Congress, and is unlikely to become law until the summer, and then quite probably with some amendments and omissions.

Meanwhile, Janet Yellen, Treasury Secretary in the new Administration, has outlined plans to raise taxes on corporates in an effort to begin paying for some of the financial support that has been provided during the Covid crisis. Alongside these plans, there are new proposals on the taxation of multinational corporations, which will be put before other leaders at the forthcoming G7 summit in Cornwall, in the hope of breaking the long-standing international logjam over low-tax jurisdictions and the taxation of America's tech giants.

America's approach to tackling the pandemic has been notably different from that followed in most other advanced economies. There have been cash payments to individuals and enhanced unemployment benefits, but no short-time work schemes. Only time will tell whether this was the best approach. Certainly, it wasn't a low-cost option, with the budget deficit likely to come in at around 15% of GDP in the present fiscal year, which ends in September.

In the short-term, economic activity is set for a strong rebound, fuelled by the fiscal stimulus from the American Rescue Plan, and by rapid progress with Covid vaccination which paves the way to re-opening of service-sector activity. Having forecast GDP growth in 2021 of just 3.5% in our previous Update, when the country was being ravaged by Covid, we now expect the US economy to notch up impressive growth of 6% this year, and of close to 4% in 2022. Indeed, GDP is likely to return to its pre-Covid level in the middle of this year, though quite how America got through 2020 with an annual fall in GDP of just 3.5% is something of a statistical mystery.

But, with America having eschewed the use of furlough schemes, it's going to take over a year to get the labour market back to full health. The unemployment rate in March was 6.0% – much lower than the peak of nearly 20% reached last April, but still high by (pre-Covid) recent standards. To put it another way, the proportion of those aged 16 or over who are in work stood at 57.8% in March, compared with 61.1% in early 2020. The increase in nonfarm payrolls in March of over 900,000 moved the employment/population ratio by 0.2 percentage points, suggesting that it will take another 15 months of similarly strong jobs growth to repair the damage.

The question of how long it will take to return the labour market to health is important, as this is one of the conditions that must be met before the Fed considers raising interest rates. The other requirement is that inflation must not only return to the 2% target, but that it should be set to run above target for an extended period. On this basis, nothing is likely to happen until 2024 at the earliest. HSBC's forecasts only look to the end of 2022, but have no increases penciled in before that point. The only tangible shift in policy by then is likely to be a tapering of asset purchases. These are presently running at $120 billion a month, but could well be slowed from the end of this year.

The risk, as in other advanced economies, is that consumers go on a spending spree and once again pile into the residential property market. The question then would be whether – regardless of conditions in the labour market – the Fed could really keep sitting on its hands in the face of a housing market bubble and accelerating consumer price inflation. The recent rise in bond yields suggest that financial markets believe that the imminent economic recovery will prove to be inflationary, and that the Fed will be forced to act on interest rates somewhat sooner than it says it wants to.

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The Euro Area – new restrictions

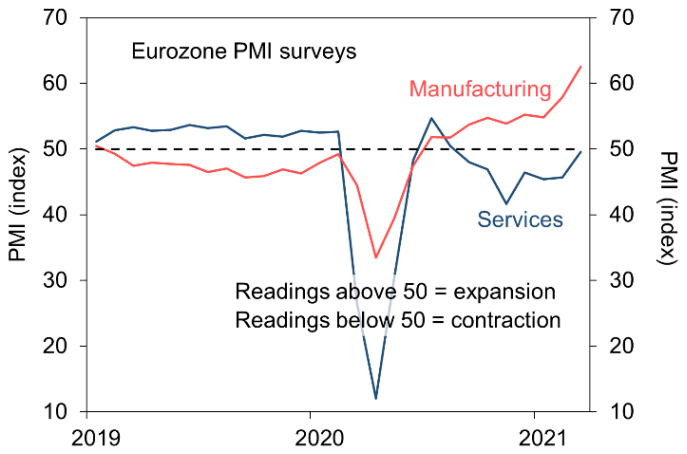
Another wave of Covid infections has now spread across much of continental Europe. Plans to re-open service sector activities have therefore been postponed, and many countries or regions have seen stricter measures introduced, such as the four-week national lockdown in France. With the vaccine roll-out lagging behind Britain and America, health systems have again found themselves under severe pressure, so that any meaningful easing of restrictions is unlikely before May. The economic recovery will therefore be delayed, with consumer sentiment not recovering to normal levels until the vaccination programme has tamed the pandemic. Indeed, since our last Update, the forecast for GDP growth in the Euro Area in 2021 has been cut, from 4.3% to 3.6%: growth rates are expected to cluster in the range from 3-5%, with France and Spain leading the way among the "big four". But expectations for 2022 have been upgraded, with GDP now projected to expand by 4.0%, as against the 3.1% anticipated back in January.

Despite the relative resilience of activity during the months of winter restrictions, it was only in March that the Composite PMI broke above the 50 mark, having last been in positive territory back in September. And while the manufacturing PMI is signalling a decent recovery, the services PMI has remained slightly in contractionary territory, as it's become clear that new restrictions would be needed to curb the renewed spread of the virus.

Once recovery can get going properly, the momentum will be less strong than in the UK and the USA. For one thing, households have not accumulated savings to the same degree, because government support has been less generous. European governments have, perhaps, been fearful that the straightjacket of the Stability and Growth Pact, which was suspended at the onset of the pandemic, will soon be re-imposed. Budget deficits in 2020 were therefore nearer 10% of GDP than 15% (and less than 5% in Germany). Finally, while the EU has achieved a major milestone in gaining approval for the €750 billion Next Generation EU fund, which will for the first time involve outright fiscal transfers, by the standards of President Biden's US package it's a step-size smaller.

Given the expectation of a relatively muted recovery, the Euro Area is not likely to encounter the sort of inflation issues that may yet beset some faster-growing economies. The combination of very low inflation and stubbornly high unemployment that has persisted since the financial crisis suggests that the Eurozone isn't short of spare capacity that might be brought to bear as the economy revives. Any hikes in interest rates by the ECB are therefore several years off, so that in the meantime the focus of attention will continue to be on the size of asset purchases and the timing and pace of the eventual tapering.

The Eurozone service sector is still struggling



Source: IHS Markit

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Asia – hot manufacturing, cooler consumers

Asia has been more successful, in some respects, at tackling the Covid pandemic than Europe, North America, or Latin America. Life is pretty much back to normal in Australia, New Zealand, and Taiwan, with the notable exception that external borders are shut tight; other countries in the region have experienced relatively light or short-lived Covid outbreaks. But the restrictions that remain aren't about to be lifted soon, with many vaccination programmes getting off to a slow start. During 2020, larger countries enjoyed some economic advantage in that the whole population didn't have to be locked down simultaneously. But, as economies try to re-open, it's the smaller countries that have the advantage, as they'll be able to get their populations vaccinated more quickly. Both India and China have delivered over 100 million doses, but the job won't be done until well into next year. For some other countries, such as New Zealand and Thailand, the domestic economy may get back to normal but with an ongoing drag on overall economic performance due to the absence of international visitors.

As the world's manufacturing powerhouse, Asia has enjoyed booming exports in the past year, to meet the needs of locked-in western consumers, with the electronics sector running especially hot. This has particularly benefited Taiwan, which has been one of the world's economic star performers during the pandemic: growth in 2020 came in at a respectably positive 3%, and is projected to quicken to 5% this year. The big unknown for the year ahead is how long it will be before consumers in Europe and North America ease back on purchases of goods as their service sectors re-open. After all, how many pizza ovens does anybody need? But, while demand for consumer goods must eventually flag, those countries, such as Japan and South Korea, which lean more towards capital equipment, should reap the benefits as businesses around the world ramp up investment spending.

The more troublesome issue facing Asian economies will be the muted recoveries of spending by their own consumers. Government financial support has on the whole not been as generous as that offered in higher-income countries. This, combined with the greater success of many countries in containing the virus, means that households haven't built up 'enforced savings' to anything like the same extent. Even in China, where the recovery has been under way since the spring of last year, growth of retail sales is still shy of pre-pandemic rates.

Our expectation for growth of over 8% in China this year is in fact largely down to 'base effects': even if there was no growth at all during this year, the 2021 annual growth rate would still be around 6%, thanks to the resurgence during the second half of last year. And quite apart from the subdued consumer revival, the authorities are already gently applying the policy brakes, having become concerned about the build-up of indebtedness in some parts of the economy. In India meanwhile the blistering recovery of 11% pencilled in for this year now looks at some risk, with the country once more overrun by Covid infections. Elsewhere, Singapore, Vietnam, the Philippines, and Sri Lanka are all slated to register GDP growth in excess of 6% in 2021.

In the past, higher funding costs arising from higher US Treasury yields have tended to be problematic for at least some Asian economies. This was certainly the case at the time of the "taper tantrum", which rocked financial markets in 2013. Rising bond yields alter the risk/reward calculus for investors, causing them to switch out of emerging market (including Asian) assets. If the capital outflows become severe then currencies can fall sharply, which tends to import inflation, necessitating rate hikes by central banks. But this time around, Asian economies are, for the most part, running healthier balance of payments positions, which will make them less vulnerable. The muted consumer revival will also help keep inflationary pressures in check, which should allow the central banks some flexibility in their monetary policy response.

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The UK – a vaccine-fuelled rebound

The prospect of a strong economic rebound during the spring and summer of this year, which was cautiously anticipated in our previous Update, published in early February, is still our 'main-case scenario'. The vaccination programme has continued at pace, so that by the middle of April more than 40 million shots had been administered, with more than 15% of the population having received two doses. Infection rates, hospitalisations, and deaths are now running at their lowest since last September, while extensive genomic sequencing and surge testing has so far managed to keep new virus strains in check.

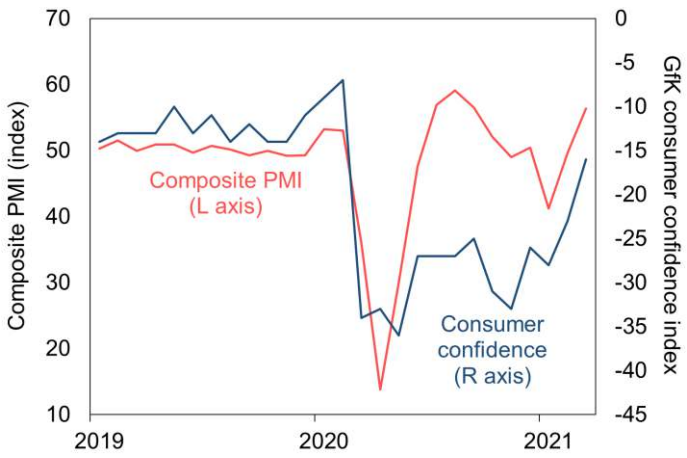
The 'road map' for re-opening the economy, announced on 22 February, set out a gradual normalization process in England, with most restrictions being lifted by 21 June. This will not only mean that nightclubs, concert venues and sports arenas can re-open at full capacity, but will also pave the way for a return to offices. Travel out of and into the UK should become easier from 17 May, with a "traffic lights" system being put in place. But, with infection rates still higher in most of Europe, quite how many people will make it to the Mediterranean sun this year remains uncertain. The other vexed issue that still has to be resolved is the manner in which people will be required to demonstrate their Covid status before being admitted to crowded workplaces, pubs, and entertainment venues.

"Start ignition sequence !"

Economic activity held up remarkably well during the dreary winter months of lockdown, with GDP declining by only 2.2% in January. That was despite the third England-wide lockdown coinciding with the new post-Brexit complexities faced by exporters and importers, and it was followed by a marginal increase of 0.4% in February. It's likely that March saw a further revival as schools returned and the weather improved. It's therefore quite likely that the contraction for the first quarter will turn out to be only around 1.5%, which is a remarkably different outcome from the first lockdown last spring, which caused GDP to plunge by nearly a fifth in the second quarter.

The survey data for March certainly bodes well for the next few months, with both business and consumer sentiment reviving. The composite reading from the Purchasing Managers' Index (PMI) surveys of businesses in the manufacturing and private sector services sectors leapt to 56.4, its best showing since September of last year, while the construction PMI topped 60. Consumer confidence has also brightened, with the GfK/NOP index surging by seven points to -16, which is its highest level since the pandemic struck. The average reading over the long history of this survey is around -10, a level that could well be attained in the next month or two, while the reading of -1 that prevailed just before the EU Referendum in 2016 might be reached later in the year.

Business and consumer confidence has begun to recover



Source: GfK, IHS Markit

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With most people still spending most of their time shut up at home, even though their children have returned to school, bank balances have continued to swell. According to the Bank of England, money held in households' bank deposits at the end of February was £1,661 billion, an increase over the level at the end of January of £21 billion, and £178 billion more than a year earlier. To put these increases in context, households would, in normal times, usually add to their stock of deposits at a rate of just over £4 billion a month.

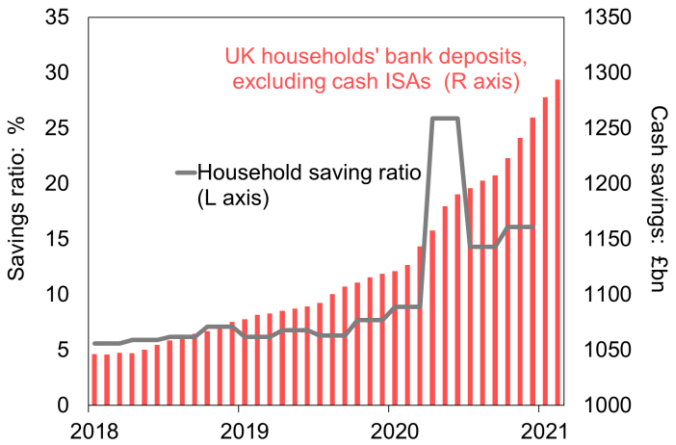
… and, "Lift off !"

In view of all these positive developments, especially the rapid roll-out of Covid vaccinations, our forecasts for economic growth in the UK have been revised upwards since the last Update. GDP for 2021 as a whole is now expected to be 5.8%, quickening slightly to 6.1% in 2022 (upgraded from our previous forecasts of 4.3% and 5.0% respectively). In terms of the quarterly profile, GDP is expected to expand by around 3% in the second quarter and by nearly 5% in the third, in the expectation that most restrictions will be lifted by June. Thereafter, growth will slow as the re-opening process nears completion, and is expected to be back below 1% from the middle of 2022.

In this scenario, GDP will surpass its pre-pandemic level in the first quarter of 2022. This is almost a year earlier than had been thought most likely as the recovery got under way last year. The reason is simple enough, namely the speedy discovery and licensing of effective vaccines, and their rapid deployment. In fact, it's not beyond the realms of possibility that the UK's recovery could be even stronger than these forecasts, with some analysts now talking in terms of annual growth for this year reaching 7-8%. As usual, it will be consumers who will power this recovery. But while they clearly have the resources to deploy, it remains uncertain what choices they will make between spending, paying down existing borrowings, or hanging onto their money to reduce their future borrowing. After so long a period of consumers being denied those choices, the expectation that they might increase their spending during 2021 in real terms by 7% doesn't appear over-ambitious.

It's true that much of the enforced savings of the past year is in the hands (or the bank accounts) of the well-to-do middle classes, whose propensity to spend is not as high, compared to those on lower incomes and in younger age groups. But it's also important to bear in mind that with the furlough scheme extended until September, the labour market isn't expected to be hit as hard as was feared last year. The unemployment rate is forecast to top out at 6.0% later this year, and while that's an increase of more than two percentage points from the final months of 2019, by the standards of the past 50 years it's still fairly low. More to the point, the quicker and stronger the recovery, the less long-term economic 'scarring' there will be, and the smaller the dislocation to the labour market.

Enforced savings



Source: ONS, Bank of England

Investment spending is set to rise too

In the wake of the Chancellor's Budget announcement of the "super deduction" investment incentives, it is likely that capital spending by businesses will also increase. Businesses, like households, have accumulated cash balances during the pandemic, with sterling deposits held at UK banks increasing by £123 billion in the year to February 2021, an increase of 29%. While some of this is down to reduced working capital requirements during lockdown, or postponing capital expenditure, some of it represents the unused portion of borrowings that have been taken on to tide businesses through the pandemic. Having fallen sharply in the second quarter of last year, fixed investment spending rebounded in real terms by nearly 6% in the final three months of the year, albeit that it remained over 7% below the pre-pandemic level.

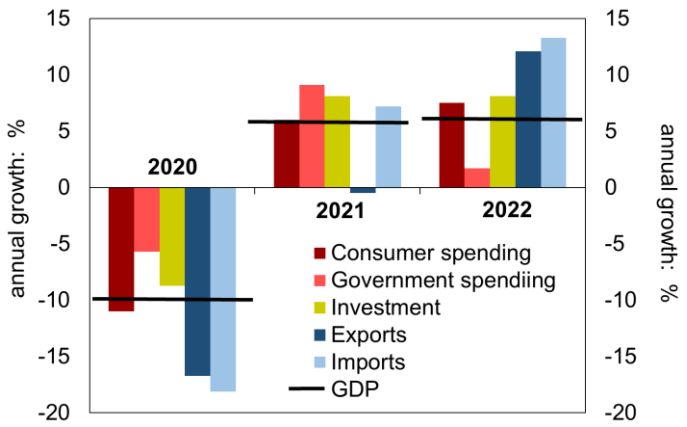
With businesses leading the way, and households no doubt also keen to disburse some of their enforced savings into the residential property market, overall fixed investment spending is forecast to increase in real terms by around 8% both this year and next.

Exports: late to the party

The one area that will underwhelm this year, as the rest of the economy expands at a blistering pace, is exports. It's not just the adjustment to the new Trade and Co-operation Agreement (TCA) with the EU that is proving problematic, but also the relatively sluggish pace of recovery in some of the UK's major overseas markets. Taking 2021 as a whole, export volumes are expected to be little-changed from 2020, although the trend will improve later in the year after a weak start. But even assuming that a brisk rebound continues through 2022, sufficient to deliver annual growth of 12% in the volume of total exports, this still implies a shortfall at the end of next year of around a tenth compared with pre-pandemic levels.

Not surprisingly, the value of goods shipped to the EU fell off the proverbial cliff in January, contracting by more than 40%. Although much of this was made good in February, it's clear that some sectors will experience ongoing difficulties, especially food and beverages. Even in February, the value of these exports to EU countries was still down by around a fifth from pre-Covid levels. And, even as sales to the EU revived in February, the value of goods shipped to non-EU countries contracted by a tenth, though this was in part down to a one-off surge in shipments to Saudi Arabia in January dropping out of the figures.

Exports: the late arrival at the UK recovery party



Source: HSBC Global Research

Economic update: 2nd quarter 2021

The public finances

Having raised some £485 billion from the markets in the last financial year, the Government is hoping that most of the Covid support measures that were put in place can be scaled back in the months ahead. An important date will be the end of September, when the Covid Jobs Retention Scheme (the furlough) will end, as will the reduction in Stamp Duty Land Tax. Even so, the forecasts made by the Office for Budget Responsibility (OBR) at the time of the Budget in March still anticipated a deficit in the 2021/22 fiscal year of £234 billion. The OBR reckoned that it would be 2025/26 before the deficit was back to roughly where it had been in 2018/19, that's to say at around 2% of GDP.

How long it takes to repair the public finances will depend, among other things, on the strength of the economic recovery and on the extent of ongoing government support. The "super deduction" is an important, if expensive, plank in the Chancellor's approach, aimed at galvanizing investment by businesses over the next two years. Thanks to this, and the successful vaccine roll-out, we expect that the budget deficit will, in fact, come in somewhat lower than the OBR's forecast. Indeed, we're hopeful that it might still come in the right side of £300 billion for the financial year just ended, and that it will be less than £200 billion in the current year. Measured as a percentage of GDP, it's expected to shrink from 14.2% to 9.0%.

Monetary policy … and inflation

With a strong recovery getting under way, there will be no need for further monetary policy loosening measures by the Bank of England. Negative interest rates have been added to the toolbox, but won't be deployed unless something goes horribly wrong (or until the next pandemic). When bond yields were rising in the early months of this year, the Bank of England was one of the more hawkish of the central banks, refusing to row back against the markets and taking the view that the increase in borrowing costs was justified by the improved economic prospects. Nonetheless, HSBC remains of the view that there won't be any hikes in Bank Rate before the end of 2022, and possibly for some while after that. It's a sobering thought that Bank Rate has been at under 1% for more than twelve years.

Over the coming months, it will be worth keeping a weather eye on pronouncements from the Bank of England about how it might set about removing the extraordinary monetary stimulus that was put in place last March. A review is known to be under way, and it is thought likely that the preferred option will be to remove at least some of the quantitative easing, before starting to hike rates. This is the opposite of what was envisioned in the last economic cycle – albeit that in the end nothing was ever done. The merit of removing the QE first is that it would postpone the date at which rates begin to rise and might mean that they peak at a lower level. This would have obvious advantages for the government, especially during the next year or two when it will still be raising considerable sums from the bond markets.

The crucial factor in determining the timing and speed of policy tightening will be what happens to inflation. With many shops and hospitality outlets closed in recent months, it's little wonder that inflation has been soft, the CPI annual rate coming in at just 0.7% in March. But as the economy re-opens, price pressures will build, with the headline rate expected to be close to the 2% target by the end of this year, and holding there during 2022. Indeed, it's on that basis that the Bank of England is expected to hold off from thinking about rate hikes for quite some time. But things might get interesting if the economic recovery is more powerful than expected, and if it's accompanied by ongoing bottlenecks in global supply chains and by rising commodity prices, a combination which could push inflation well above target.

Mark Berrisford-Smith
Head of Economics, Commercial Banking, HSBC UK.

Economic update: 2nd quarter 2021

Forecasts

Global economic growth

Annual % change in real GDP	2018	2019	2020	2021(f)	2022(f)
					(f) = forecast
World (nominal GDP weights)	**3.3**	**2.6**	**-3.5**	**5.6**	**4.1**
Developed economies	2.3	1.6	-5.0	4.9	3.7
Emerging economies	4.8	3.9	-1.3	6.6	4.6
North America					
USA	3.0	2.2	-3.5	6.0	3.9
Canada	2.0	1.7	-5.4	5.3	3.7
Asia/Pacific					
China	6.7	6.0	2.3	8.5	5.6
Japan	0.6	0.3	-4.8	3.8	1.3
India	7.3	4.8	-6.9	11.0	5.8
Australia	2.8	1.9	-2.4	4.3	2.8
South Korea	2.9	2.0	-1.0	3.4	3.0
Indonesia	5.2	5.0	-2.1	4.0	5.6
Taiwan	2.8	3.0	3.1	5.0	2.6
Thailand	4.2	2.3	-6.1	3.0	3.9
Malaysia	4.8	4.3	-5.6	5.7	5.3
Singapore	3.5	1.3	-5.4	6.5	3.5
Hong Kong	2.8	-1.2	-6.1	4.4	2.9
Philippines	6.3	6.0	-9.5	6.3	6.5
New Zealand	3.4	2.4	-3.0	3.7	3.1
Eurozone	**1.9**	**1.3**	**-6.8**	**3.6**	**4.0**
Germany	1.3	0.6	-5.3	3.3	3.6
France	1.8	1.5	-8.2	4.8	4.1
Italy	0.8	0.3	-8.9	3.5	3.8
Spain	2.4	2.0	-11.0	4.4	5.8
Other Western Europe					
UK	1.3	1.4	-9.9	5.8	6.1
Switzerland	3.1	1.1	-3.0	2.4	2.2
Sweden	2.1	1.4	-3.0	4.1	3.1
Norway	2.5	2.4	-3.1	4.7	2.5
Eastern Europe, Middle East & Africa					
Poland	5.4	4.5	-2.7	3.8	5.1
Hungary	5.4	4.6	-5.0	4.1	4.3
Czech Republic	3.2	2.2	-5.6	3.6	4.8
Russia	2.3	1.3	-3.1	3.1	2.9
Turkey	3.0	0.9	1.8	4.2	3.6
Saudi Arabia	2.4	0.3	-4.2	2.8	3.7
South Africa	0.8	0.2	-7.0	4.0	1.7
Latin America					
Brazil	1.8	1.4	-4.1	3.2	2.3
Mexico	2.1	0.0	-8.2	3.5	2.3
Argentina	-2.6	-2.1	-10.0	7.0	3.5
Chile	3.7	0.9	-5.8	7.0	4.0

Source: HSBC Global Research

Economic update: 2nd quarter 2021

Forecasts

Policy interest rates

Interest rate (%) at end-period	Mar 2021	June 2021	Dec 2021	June 2022	Dec 2022
		Forecast			
North America					
USA*	0.25	0.25	0.25	0.25	0.25
Canada	0.25	0.25	0.25	0.25	0.25
Western Europe					
Euro Area (Refi rate)	0.00	0.00	0.00	0.00	0.00
Euro Area (deposit rate)	-0.50	-0.50	-0.50	-0.50	-0.50
UK	0.10	0.10	0.10	0.10	0.10
Norway	0.00	0.00	0.25	0.50	0.75
Sweden	0.00	0.00	0.00	0.00	0.00
Switzerland	-0.75	-0.75	-0.75	-0.75	-0.75
Emerging Europe					
Poland	0.10	0.10	0.10	0.50	0.50
Hungary	0.60	0.60	0.75	0.90	0.90
Czech Republic	0.25	0.25	0.50	1.00	1.50
Asia/Pacific					
Japan	-0.10	-0.10	-0.10	-0.10	-0.10
China	3.85	3.85	3.85	3.85	3.85
India	4.00	4.00	4.00	4.00	4.00
Australia	0.10	0.10	0.10	0.10	0.10
New Zealand	0.25	0.25	0.25	0.25	0.25

* Upper end of target range
Source: HSBC Global Research (*Global Policy Rates, 12 April 2021*)

Currency exchange rates

Exchange rate at end-period		Mar 2021	June 2021	Sep 2021	Dec 2021	Mar 2022	June 2022
			forecast				
Rates against £							
US dollar	USD/GBP	1.38	1.36	1.34	1.34	1.34	1.34
Euro	EUR/GBP	1.17	1.13	1.09	1.09	1.12	1.14
Japanese yen	JPY/GBP	152	148	143	142	143	145
Canadian dollar	CAD/GBP	1.73	1.69	1.65	1.63	1.65	1.66
Australian dollar	AUD/GBP	1.81	1.72	1.67	1.65	1.67	1.70
New Zealand dollar	NZD/GBP	1.97	1.86	1.81	1.79	1.81	1.84
Swedish krona	SEK/GBP	12.03	11.22	10.79	10.68	10.94	11.13
Norwegian kroner	NOK/GBP	11.79	11.11	10.46	10.24	10.50	10.67
Swiss Franc	CHF/GBP	1.30	1.28	1.25	1.26	1.28	1.29
Other rates							
US dollar / euro	USD/EUR	1.17	1.20	1.23	1.23	1.20	1.18
Chinese yuan / USD	CNY/USD	6.55	6.50	6.50	6.60	6.60	6.60

Source: HSBC Global Research (*Currency Outlook*, April 2021)

Economic update: 2nd quarter 2021

Forecasts

UK economy

annual % change, adjusted for inflation (except where otherwise stated)

		forecast	
	2020	**2021**	**2022**
GDP	-9.9	5.8	6.1
Consumer spending	-11.0	6.0	7.7
Government spending	-5.7	9.1	1.7
Investment	-8.7	8.1	8.1
Stockbuilding (% of GDP)	-0.6	-0.6	-0.5
Domestic demand	-10.5	8.0	6.6
Exports	-16.7	-0.5	12.1
Imports	-18.1	7.2	13.3
Manufacturing output	-9.0	7.3	3.3
Unemployment rate (%)	4.6	5.7	5.4
Average earnings	1.8	3.1	2.0
Inflation - CPI	0.9	1.2	2.0
Current account (US$ bn)	-105	-122	-140
Current account (% of GDP)	-3.6	-4.0	-4.3
Public sector net debt (% of GDP)	102.6	98.7	100.1
Public sector net borrowing (% of GDP)	14.2	9.0	5.9
Exchange rate[1] US$ / £	1.37	1.34	--
Exchange rate[1] € / £	1.12	1.09	--
UK Bank Rate[1] (%)	0.10	0.10	0.10

1. at end-period.

Forecast as at 22 April 2021; data and forecasts are subject to revision

Source: HSBC Global Research

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