

»Global Macro Environment: Outlook for 2021

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CIO outlook 2021: Central banks have once again opened the floodgates

The global economic recovery from the trough of the pandemic is continuing worldwide. At the same time, central banks are providing markets with a healthy supply of liquidity. In addition, the large-scale distribution of effective vaccines against Covid-19 will start in the first quarter of 2021. Financial markets are benefiting from this favourable situation and are unlikely to get into serious trouble until inflation rises considerably.

Economic outlook

Economic growth in the US has so far been only marginally slowed down by the huge second wave of Covid-19. It is particularly noteworthy that unemployment is declining steadily. The housing market also remains in an extremely strong condition and household cash balances are still at a high level. This provides a solid foundation for continued high consumption of goods and a further recovery of the US economy.

The latest economic indicators also point to a very robust development in China. Meanwhile, many of these signals are well above pre-crisis levels. China also has a positive influence on many emerging markets. Europe brings up the rear globally, but we see potential for catch-up here. In relative terms, many European companies in previous Covid-19 problem sectors should benefit more from the vaccines and thus a possible end to the pandemic. Although vaccine logistics are facing major challenges, especially in many emerging markets, more than five billion doses of vaccine have already been announced by American, British and Russian manufacturers for worldwide circulation. The distribution chains are already being tested in the US.

The nomination of former Fed Chairwoman Janet Yellen as Secretary of the Treasury is a signal that the new US president is capable of putting together a top-class and efficient administration. Yellen has enormous knowledge of both economic matters and monetary policy, and is highly regarded worldwide. This will allow a much more relaxed and efficient cooperation both domestically and internationally, thus further strengthening the global economic upturn.

However, there are still uncertainties around the effectiveness and distribution logistics of Covid-19 vaccines. In addition, there is a high level of vaccine skepticism among the population in many countries. These factors could delay the fight against the pandemic, and thus dampen economic activity.

Favourable environment for financial markets

The favourable environment is confirmed by various leading indicators. The highly cyclical copper price and those of other industrial metals are rising, reflecting strong industrial demand. The oil price is also rebounding. The energy sector is an important factor for global growth. Stock market moves show that market breadth is high while a healthy sector rotation is taking place. This leads to more balanced valuations, as the previously cheap Covid-19 losers become more expensive, while the previous winners come under pressure.

At the same time, the central banks provide the system with a generous supply of liquidity. After a temporary hiatus, both the Fed and the ECB have increased their purchases of securities (quantitative easing) again and are likely to continue to do so for the foreseeable future. The M1 and M2 monetary aggregates, which are of particular importance to the stock markets, are rising at an undiminished pace.

This has created a strong foundation for equity and credit markets. However, a lot of good news has been priced into the markets in recent weeks. As a result, the well supported rise in stocks should continue for the time being, but at a more moderate pace. Interest rates also have slight upside potential.

Despite this very favourable starting position, there are potential risks. A further fall in the US dollar could push up inflation expectations and long-term interest rates in the US, potentially posing problems for the Fed in the medium term. Loose monetary policy would have to be curbed and the Fed would have less room for manoeuvre.

However, current trends in the US dollar, inflation and long-term interest rates are still very moderate. In the short term, a weaker dollar could even lead to a stronger economic growth. Many emerging markets and also the ECB could loosen their monetary policy even more if the dollar was weak, thus contributing to a global "reflation" of the system. Central banks therefore tolerate these trends and would only intervene much later in the cycle, in our view, namely when the markets force the issue or money multipliers rise too sharply and inflation pressures increase. As long as inflation remains under control, we see few reasons for a major trend reversal in financial markets.

Chart: A weaker US dollar could lead to higher interest rates via higher inflation



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