

Top Trends: Financial Fragility

# The Rise of Delta Variant Vs. Global Inflation

September 2021



Episode 1



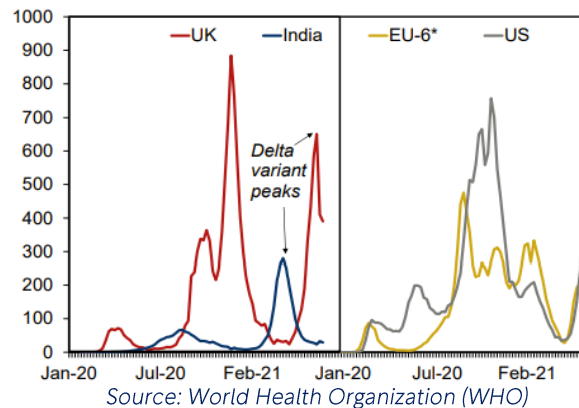
A year ago, the biggest question for investors was how quickly the global economy would recover from the depths of the COVID-19 recession. Today, the answer is clear: After the single largest drop in quarterly gross domestic product (GDP) on record, GDP is already back on its pre-COVID-19 path. Now, the debate is whether the strong recovery and pick-up in inflation are part of a short-lived spurt, driven by policy support and economic reopening. Or, this recovery has staying power, with forecasts for 6.5% global GDP growth for 2021 led by the US economy's 7.1% growth, followed by 4.8% globally and 4.9% for US in 2022.

The biggest surge in US inflation in 13 years could stretch into 2022 owing to persistent shortages of labor and materials, especially if the delta coronavirus strain delays the full reopening of the economy. That's one of the big takeaways from the minutes of the Federal Reserve's last big meeting in July. The rise of the Delta variant has added concerns about the strength of the global recovery. These concerns were already present before Delta due to the very uneven rollout of vaccines across the world. This unevenness implied restrictions on both domestic activity and international travel would last much longer in some places. Our forecasts for trade levels show that while world trade in goods returned to Q4-2019 levels in Q1-2021, however, we expect depressed travel and transport will keep services trade below pre-pandemic levels until 2024.

Delta threatens to complicate the exit from restrictions even for highly vaccinated societies. For economies with low vaccination and immunity levels, the consequences could be more severe. The path of the Delta outbreaks in India and the UK, both of which seem to be past their peaks, gives cautious grounds for optimism, as do tentative signs of peaks in parts of the EU. But Australia's shift to extensive lockdowns is a more worrying development.

**Delta variant causing new infection surges, but Indian and UK cases have peaked**

**World: Coronavirus cases**  
Cases per million population



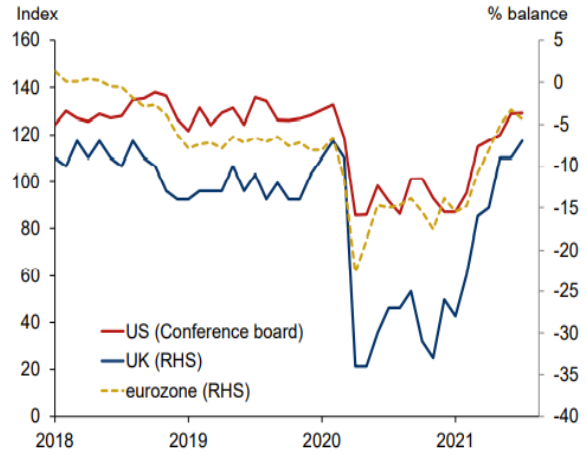
Source: World Health Organization (WHO)



So far, the rise of Delta doesn't seem to have had a big impact on high-frequency global economic indicators. Consumer confidence readings for July in the advanced economies also held up well; they were steady in the US and Germany and there was a modest improvement in the UK, despite relatively high numbers of COVID-19 cases there. In all three economies, confidence has now regained pre-pandemic levels. Powerful tailwinds are still supporting consumer spending in the advanced economies. Aside from the impact of reopening in various sectors and rising vaccination rates, there is the large mass of excess savings accumulated over the last 12-18 months and the rapid growth in household wealth. Indeed, we expect a 17% rise in real household net worth this year in the US, the fastest in decades.

### Consumer confidence is holding up in advanced economies so far

#### Advanced economies: Consumer confidence

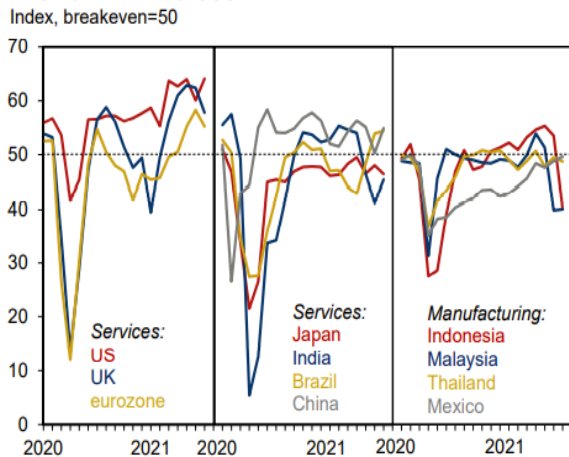


Source: The Conference Board & OECD Data

Looking at services PMIs which are highly sensitive to coronavirus related restrictions, you could see that the picture is positive in those advanced economies that have posted strong numbers. Indeed, the July non-manufacturing ISM for the US showed a surprising further rise despite increasing COVID-19 cases. The biggest problem for the US still seems to be on the supply side rather than with demand. The impact of a renewed surge in COVID-19 cases is, however, visible in high frequency indicators in parts of Asia and other emerging economies. In Japan and India, the services PMIs are in contraction territory, while in Brazil the PMI has just started to emerge from a mid-year fall. Even manufacturing is struggling in some places. PMIs for Mexico and Thailand point to stagnant output, while in Indonesia and Malaysia, the PMIs have slumped deeply into contraction territory in recent months. These latter developments are perhaps the clearest current indications of the risks to world growth from the rise of the Delta variant.

### Effects of rising Covid cases are most notable in some emerging economies

#### World: PMI indices

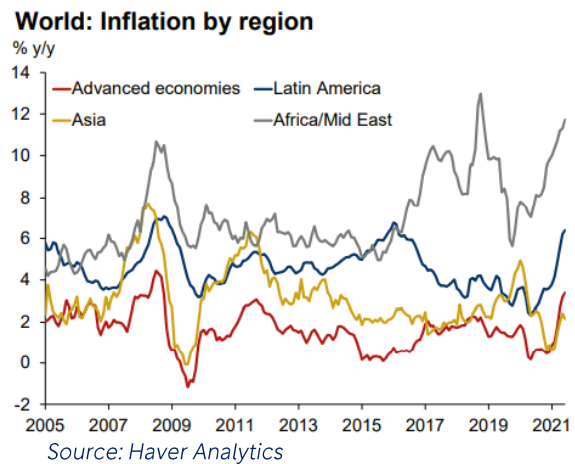


Source: Institute for Supply Management



What about inflation risks? To some extent the rise of the Delta variant has taken attention away from this threat, as have cooling global bond yields. We've also seen some positive developments in terms of long-term inflation expectations. Analysts have retreated the probability of a sharp rise in inflation over the next five years from a high of over 40% to around 33% now. It would be wrong, however, to assume inflation risks have retreated entirely. Headline and core Inflation in the advanced economies will further spike. In emerging economies, the picture is considerably worse. Inflation is running at over 6% in Latin America and 12% in Africa and the Middle East. Central banks in emerging economies generally lack the accumulated anti-inflation credibility of those in the advanced economies, meaning less scope to hold back from tightening policy as inflation rises, as the recent 100bp rate hike in Brazil demonstrates. This is another risk area for global growth.

### Inflation rates are still rising – especially in some emerging regions



Moreover, the steroid-driven US fiscal policy since the peak of the COVID-19 pandemic has caused a surplus of US dollars in the financial markets. Guess the amount of dollars the US has pumped into the economy so far? our calculation puts a figure close to 5 trillion USD. The previous US administration announced two stimulus packages, of 2 trillion USD and 900 billion USD, within six months last year. The Joe Biden administration, on the other hand, signed a 1.9 trillion USD stimulus package so far. And while more funds are likely to be stuffed into Biden's 2.3 trillion USD infrastructure bill, the Republicans are already blaming the federal aid of 300 USD per week to people for the job market recovery. So, liquidity in the economy is at an all-time high and, expectedly, inflation is coming back in a big way.

The problem is not just restricted to US domestic inflation. A significantly weakened dollar has also resulted in commodity prices rising sharply around the world. Prices of coal, copper, iron ore and many other basic raw materials are rapidly increasing, whose effect will eventually percolate to the manufacturing sector and then to the consumers. Already, steel mills in China are paying higher prices for these basic materials, as are manufacturing companies in other sectors. Chinese companies may probably weather through this round of inflation with increased productivity, efficiency gains and moderate price increases. But when the global inflation wave starts hitting the food sector, many poor people in the developing world, particularly in Africa and parts of South Asia, will bear the brunt. Some people could even face starvation. This is the kind of casualty statistics that usually may not go into the official accounts of the impact of the pandemic by governments and international organizations.



## Here are four points for investors to consider on the economic road ahead:

### 1. Consumers Have Money to Spend

The sharp rebound in consumption lifted global growth, and we project that this surge in spending will continue. Despite higher levels of unemployment over the past year, average US household income has already exceeded its pre-COVID-19 level bolstered by economic-impact payments and supplemental unemployment benefits. In addition, many households, perhaps surprisingly, have excess savings due to the pandemic. The US Economist estimates that, between March 2020 and April 2021, US households built up about 2.2 trillion USD in total excess savings.

### 2. Corporate Capital Spending Will Sustain Growth

Companies are also looking to spend. With growth prospects brightening, as we move deeper into the recovery, companies are investing again. This would set up the world economy for a red-hot capex cycle that could lift global GDP above its pre-COVID-19 path, starting in the third quarter of 2021. We believe that global investment could reach 115% and 121% of prerecession levels, by the end of 2021 and 2022, respectively. Historically, it's taken twice as long to reach those levels. Indeed, capex took 10 years to recover after the Global Financial Crisis.

### 3. DMs Leading, EMs to Follow

The US economy is playing an outsized role in driving the strong global growth story in this cycle; but other markets should benefit from similar dynamics, as vaccination rates and reopening progress. In developed markets, the surge in domestic demand should lift output and corporate confidence. Noting that it is forecasted that GDP growth for developed markets record 5.5% and 4.6% GDP growth in 2021 and 2022, respectively. The 2021 outlook includes 4.3% growth for Europe, 6.4% for the UK and 2.5% rebound for Japan. Emerging markets, meanwhile, are already benefiting from strong external demand. We believe GDP growth in these markets could reach 7.2% this year, led by China and India. While slower vaccination rates are hampering domestic demand there, these countries will eventually see their own spending rebound.

### 4. Inflation Is More Than Just a Number

Finally, the inflation question. Although US inflation have peaked in May to June, transitional factors, such as supply constraints and contained demand, are likely to lead to large swings in inflation data. All told, we see US core inflation settling above 2% for this forecast period. Still, higher inflation may not mean higher rates. We could feel the Fed on track to deliver the first-rate hike in the third quarter of 2023, with a gradual removal of policy accommodation thereafter. This is all to say that the macro environment is shaping up to look very different from that of the post-2008 recovery. After the financial crisis, fears of stagnation rose. But this time around, active and aggressive fiscal and monetary policies have limited the scarring effects and kept private-sector risk appetites buoyant.

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