# Mizuho Global Perspectives

London **28 May 2021**
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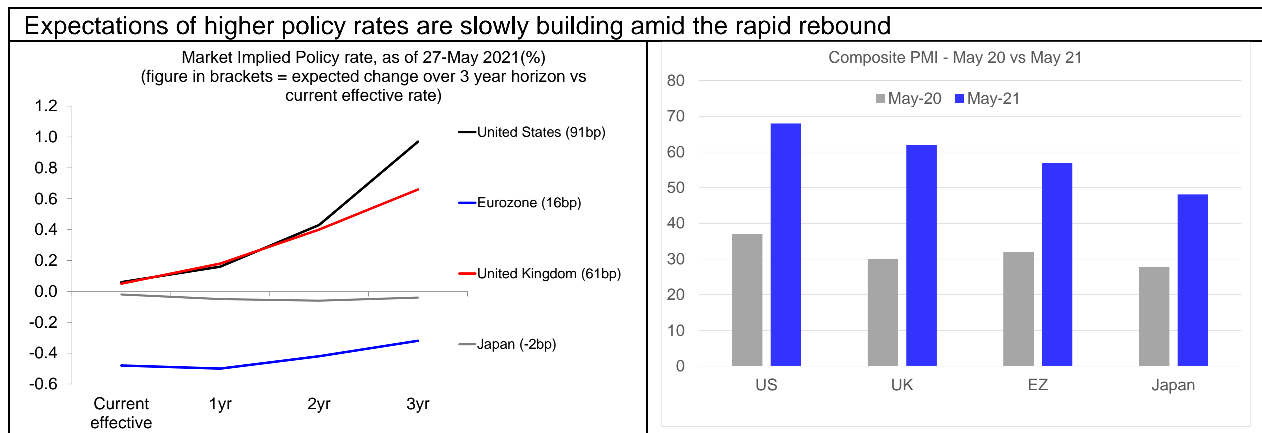
**Forecast update – June 2021**

**Supply chains under strain. Price pressures in focus amid the re-opening boom**

The UK and the US are booming and with its vaccination roll-out picking up the pace, the Eurozone looks set to follow in short order. Japan is alas in the slow lane, with renewed restrictions extended through 20 June, which in turn will leave Q2 GDP soft and push the recovery firmly into H2. The PMI survey data suggest that delivery times, input and output price pressures are at or near record levels across a wide range of economies amid the unprecedented surge in activity. The supply side has struggled to keep up in the short term with even labour markets suffering difficulties, despite unemployment rates remaining elevated. The key question for central banks is to what extent these pressures will feed through to consumer prices. We assume some modest pass through to the CPI in the short term in the UK and the Eurozone and push our CPI forecasts a little higher accordingly. In the US, where the economy is already operating at higher capacity rates, the pick up is greater and we have pushed our 2021 CPI forecast up from 2.4% to 3.2%. Note the 2022 CPI forecast for the US is only 0.1pp higher at 2.2%. We continue to expect that the higher consumer prices will be mainly transitory.

The BoC and the RBNZ have recently suggested policy tightening is under consideration in coming months but we see limited near term action for the central banks covered in this publication. Whilst the economic risks of overheating in the US are greatest, the Fed's switch to Average Inflation Targeting last summer also makes it the most dovish of the G4 central banks. Its determination not to react to forecast inflation but only to actual inflation, especially that generated by rising wages stemming from a tight labour market, means that it is in no rush to tighten policy. It will take its time talking taper. The BoE sees supply and demand as roughly in balance and this makes it the prime candidate for the first hike. It will cease asset purchases at the end of 2021 and we expect a first hike in 2023. The ECB is unlikely to be anywhere near achieving its inflation goal when the PEPP ends in spring 2022. It seems likely that the Asset Purchase Programme will be re-jigged to plug the gap left by the PEPP. ECB rate hikes do not look likely anytime soon. The prospect of a BoJ policy tightening looks even more distant. Indeed, if the BoJ had any good options for easing policy further it would likely have taken them by now.

Expectations of higher policy rates are slowly building amid the rapid rebound

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## US economy – Initial surge over. Strong and steady from here

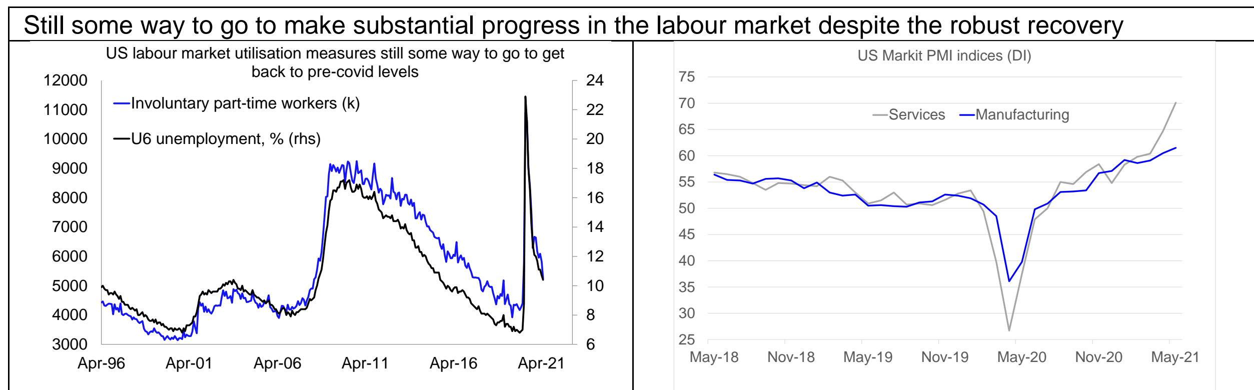
Q2 survey data have been very strong. We currently see GDP rising ~8.0% saar in Q2. That said more recent data caution against growth going parabolic. Recent housing data have been soft, May consumer confidence edged lower and April retail sales were almost flat. The US vaccination pace has slowed too. The premature winding back of jobless benefits in some states will hit growth in Q3. Labour supply picked up in April but the increase was accounted for by male workers, suggesting that school closures, and their resulting impact on female labour supply, remain the major issue for the labour market rather than elevated benefits. Labour market supply may be constrained until September, when most schools go back, extended unemployment benefits end and vaccination rates will be higher, reducing fear of Covid. We see the headline rate pushing down towards 5% by end 2021, leaving the annual average around 5.5%. With the unemployment rate around 5% at year end, we suspect the Fed still will want to see further substantial progress towards its goals and we see tapering as unlikely to start until mid-2022. Base effects and bottlenecks are likely to keep headline inflation above 3.0% for the rest of the year. However, inflation in 2022 remains on track to be significantly lower than in 2021 at around 2.2% on an annual basis.

**Policy – both fiscal and monetary policy highly stimulative, as the Fed remains patient**

The fiscal side of the US policy mix remains the key focus for investors given the scale of Biden's plans. Infrastructure spending will mainly be funded by tax increases, in sharp contrast to the $1.9trn stimulus package. We expect the multiplier associated with the stimulus package to be low, while the bulk of the spending associated with the infrastructure packages will fall beyond 2021. Vice Chair Clarida recently noted that discussing tapering may be possible at upcoming meetings, which represents a change in tone from a key policy dove. Policymakers have reiterated that they see base effects and bottlenecks as mainly temporary factors, stressing that wage-driven inflation is what they are looking out for. We do not expect that any pickup in inflation will be sustained enough to trouble the Fed. By end 2021, we see Fed policy unchanged in terms of the policy rate and the pace of bond purchases, but expect investors will anticipate tapering in 2022 with the dovish Fed pushing expectations for a first hike into late 2023 and beyond.

**Rates – UST curve to keep steepening near term but a lot of good news is now priced in**

The short end of the yield curve should be well anchored while expectations of elevated fiscal spending/rapid recovery should push longer-dated yields modestly higher. We see 10yr UST yields ~2.0% by mid-2022.

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## Eurozone economy – Entering the sweet spot

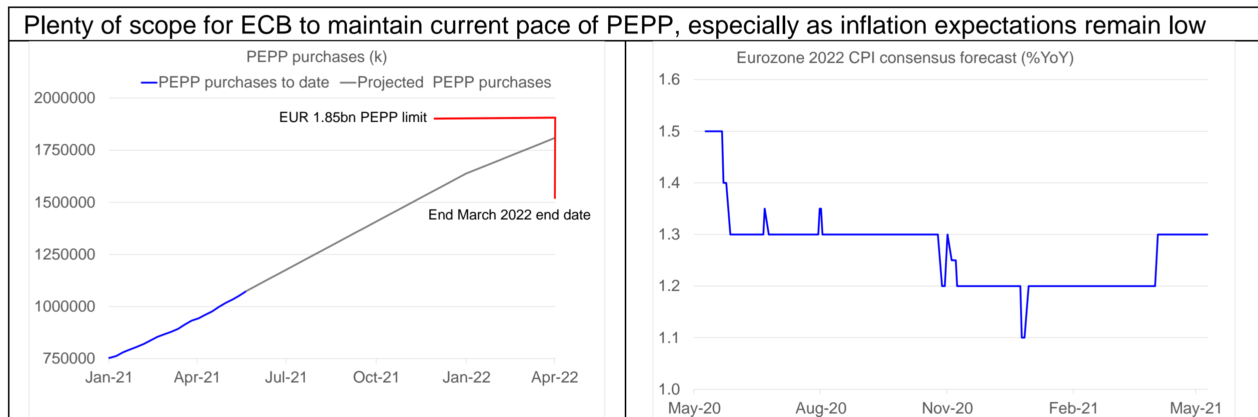
Recent survey data have been very good and we expect to see further improvements in coming months as the Covid case count drops, the vaccination rate rises and restrictions on activity are lifted. We see Q2 GDP rising 1.5%QoQ and even faster growth in Q3. Our 2021 and 2022 GDP forecasts remain at 4.3% and 4.1% respectively. The PMI survey points to record (at least over the past 23 years) pressures on supply chains and producer prices. We nudge our CPI forecasts a little higher on the expectation that some of these pressures will leak into consumer prices. Around 35% of the EU population have been vaccinated with at least 1 dose. At the current pace it will take ~4 months to vaccinate 75% of the population. We assume governments will keep labour market support programmes running for much of 2021 and any pick up in unemployment is limited. The recent jump in inflation is welcome even if it is driven by base effects. Energy/commodity price gains will briefly push headline CPI above 2%YoY over the summer but with elevated levels of slack in the economy a wage/price spiral is highly unlikely. The Eurozone CPI will average around 1.3% in 2022.

**Policy – National fiscal policy taking up any slack. ECB to maintain PEPP pace**

In the run upto the June meeting ECB speakers have been both vocal and dovish. Sufficiently so to suggest that maintaining the current pace of PEPP purchases for the time being is the likely outcome. Higher Bund yields seem justified by the improving situation but wider sovereign spreads vs Bunds are a concern for the ECB. The ECB has recently focussed on financial conditions, and these are little changed since the March meeting. Thus despite a potential upgrade to the near term growth forecast and a more neutral balance of risks, there is no need to slow the pace of PEPP purchases. We expect the bulk of the PEPP envelope to be used and the programme to end in March as scheduled. That said, the APP looks likely to be pressed into service as a PEPP substitute next year to keep any rise in EGB yields limited. The EU fiscal pact is likely to remain suspended at least until 2022 giving individual countries scope to support the recovery, as they are doing with Spain recently extending its furlough programme. In addition, the Next Generation EU (NGEU) fund will kick into gear in H2. Italy is the major focus. Draghi has pushed his proposals through parliament. The focus now switches to implementation.

**Rates – Short end pegged. Longer end yields to push higher in autumn as PEPP purchases edge lower**

Policy rates are unlikely to move much any time soon and short-term bond yields are pegged. At the long end slower PEPP purchases late in the year could see 10yr Bund yields edge a little higher.



Plenty of scope for ECB to maintain current pace of PEPP, especially as inflation expectations remain low

*Source*: Bloomberg, Mizuho



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## Japanese economy – In the slow lane

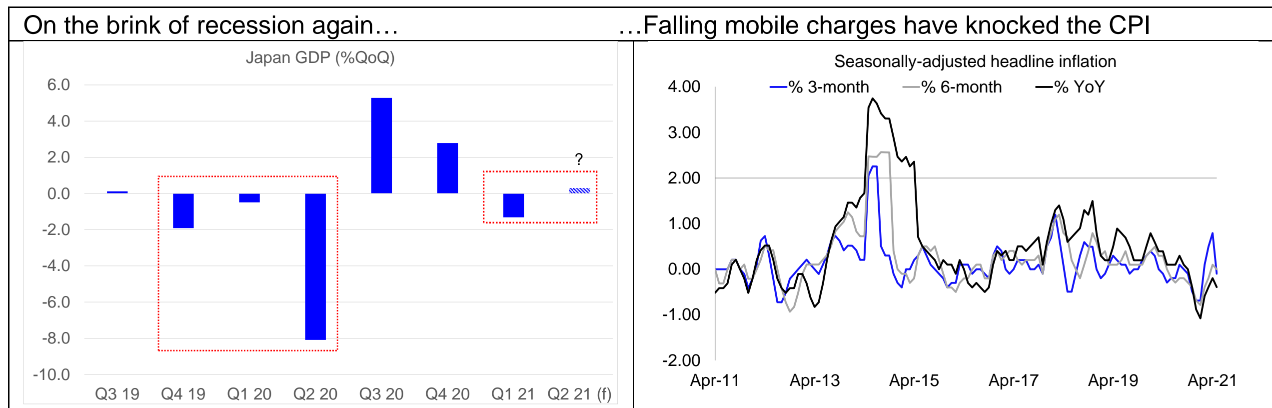
Q1 GDP was a little weaker than we forecast. Furthermore, additional restrictions have been imposed over a wider range of prefectures in recent weeks as the Covid case count rises. These restrictions have now been extended through 20 June. This will hit Q2 GDP growth. For now we still expect that Q2 GDP will be positive but only marginally so at around 0.3%QoQ. The recovery is now clearly an H2 affair. The vaccination programme is underway but remains slow, despite the rate quadrupling since the start of May. To date only ~5% of the population have had one jab – among the lowest in the OECD. We expect the Olympics will go ahead but whether domestic spectators will be allowed is in the balance. The Games should help boost consumer sentiment even if the boost from inbound tourism is missing. Our 2021 GDP forecast is now 2.3% (vs 3.2% previously), with 2022 revised up to 2.8% (vs 2.2% previously). The rising virus count has hit government popularity and the Lower House election is now likely to be held as late as possible. Changes to mobile phone charges have pushed headline CPI lower by around 0.5pp. Thus headline CPI will be slow to rise despite the impact of higher energy prices. We look for the CPI to average 0.1% in 2021 and 0.5% in 2022.

**Policy – Monetary policy struggling to add stimulus, leaving the onus on fiscal policy.**

Fiscal policy will be determined by the Covid crisis. Additional spending will be forthcoming, most likely late in 2021 in the form of another supplementary budget, to limit the fiscal cliff. The pandemic remains the driving force and we expect that the labour market and company support measures will remain in place deep into 2021, thus limiting the degree of fiscal retrenchment this year. We see no change in monetary policy over the forecast horizon but the bias is clearly dovish, as the central bank continues to undershoot its 2% inflation target by some margin. A lack of effective easing options is what keeps the BoJ on hold. The March policy review resulted in minimal substantive change - lower ETF purchases and a slightly wider range for 10yr JGB yields. The BoJ also laid the groundwork for lower interest rates if required, although the softer yen in recent months likely means the Bank has no plans to deliver on lower interest rates for the time being.

**Rates – BoJ still in control of the curve, despite a slightly wider trading band.**

The JGB market will have few problems absorbing any additional issuance. Any long end sell-off is likely to be limited given solid demand from lifers and pension funds. We expect that the BoJ will continue to be successful in its efforts to keep the sub-10yr JGB yield curve within the new 0.0% +/-25bp range.

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## UK economy – Rapid recovery

The UK is rapidly emerging from lockdown as the Covid case count plunges amid significant progress on the vaccination front. Over 55% of the population has had at least one dose, with 35% fully vaccinated. The route out of lockdown remains on track and the economy is responding well. The standout data release of the last month is the 9.2%MoM surge in retail sales in April, with the composite PMI for May pushing above 60. Q1 GDP was a little firmer than expected. We push our 2021 GDP forecast up for a second consecutive month from 6.0% to 6.7% but 2022 down from 4.7% to 4.3% - mostly a faster rather than a stronger recovery. We still see it taking to mid 2022 before UK gets back to pre-Covid levels. The CPI jumped in April and should pick up further as the contribution from energy prices increases. There will be another jump in autumn as VAT cuts drop out of the annual comparison and additional base effects in energy bills hit. The elevated supply chain pressures have led us to revise up our 2021 CPI forecast a little as we see some pass through. We now see 2021 CPI at 1.6% up from 1.5% previously. However, we suspect underlying price pressures will remain subdued and that the MPC will be more focussed on growth than inflation in the coming year, as unemployment remains elevated.

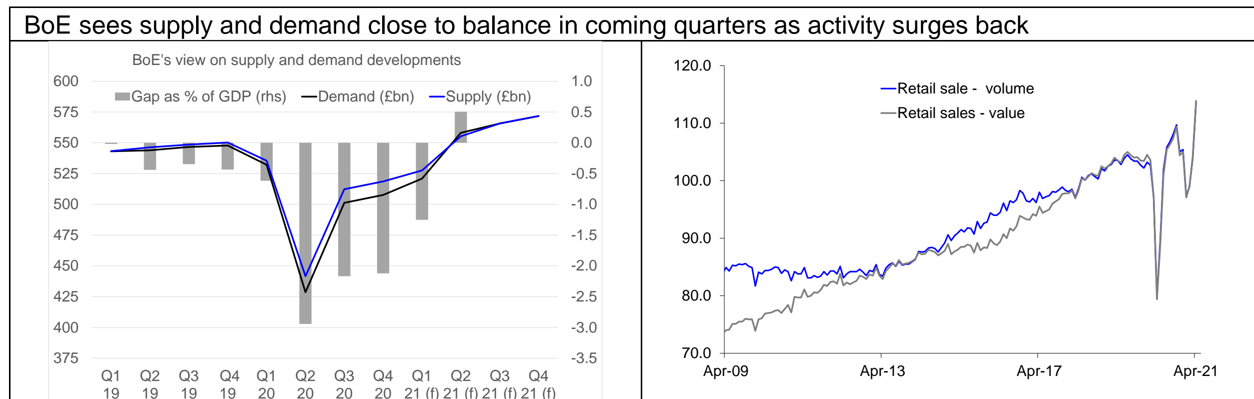
**Policy – BoE is towards the hawkish end of the spectrum of central banks amid supply side focus**

At the May MPC meeting the Bank slowed the pace asset purchases a little as expected and purchases will now end around year end as previously suggested. The Bank also sharply upgraded its growth forecast. It sees the bulk of the 2020 Covid drop made up in 2021. It also sees supply and demand as being close to balance for much of the remainder of the forecast horizon, suggesting that it would not take much in the way of stronger demand or weaker supply to see a hawkish bias emerge. The supply focus is unusual among major central banks, which for the most part seem more interested in demand. This is possibly because the MPC is dealing with the Brexit impact as well as the Covid impact on the labour market. The BoE is currently reviewing the sequencing of policy tightening with Governor Bailey potentially favouring some run off in the balance sheet before hiking rates in contrast to the previously stated policy of hiking rates first.

**Rates – Gilts set to come under modest pressure as economy recovers**

2-year Gilt yields will remain in positive territory. With the data strong and uncertainty about upcoming appointments to the MPC (Haldane and Vlieghe both depart soon) there is a little more risk at the front end in the UK than elsewhere, especially towards the back end of the forecast horizon. Longer-term UK yields will likely move higher as the recovery progresses.

BoE sees supply and demand close to balance in coming quarters as activity surges back

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**Forex view – Eurozone recovery to lift EUR**

With the US leading the global recovery, 10yr UST yields led global bond yields higher in Q1, giving the US dollar a lift, especially against the safe havens JPY and CHF, where yields rose much less. The US is back among the high yielders in the G10 universe. However, in Q2 to date, USTs have underperformed, weighing on USD. Inflation fears remain elevated and we expect that the Fed will remain resolutely dovish, which will see market pricing of the first US rate hike drift out towards 2024. Market expectations of tapering will likely be pushed back too, despite the Fed's acknowledgement that the time to start discussing tapering is approaching. We expect tapering discussions to have a dovish outcome. On a relative basis US real rates are likely to be less supportive for USD going forward. US equity markets remain expensive on a relative basis and are susceptible to adjustment, especially as the reflation trade will undermine inflows into the tech sector. Capital inflows to the US are likely to slow. The US fiscal metrics look poor and the twin deficits are rising fast. These conditions suggest to us the US dollar will remain under modest pressure in the coming 12 months.

The BoJ's crisis response underscores its relative lack of policy space. The March policy review resulted in minimal change. The BoJ's forecasts from the late April meeting underscored that the 2% inflation target is unlikely to be reached during Kuroda's term. We expect Japanese institutional investors on the fixed income side to continue to hedge and for portfolio outflows to remain subdued through the remainder of 2021. Corporate outbound FDI and M&A activity should remain subdued in the near term, as companies prioritise survival/liquidity over expansion. The data here require watching, as Q1 outflows picked up. It remains to be seen if this was the start of a recovery or just short-term pent up demand. JPY should also benefit from Japan's vaccination programme catching up in H2, which should boost sentiment. Looking into 2022, the boost from vaccination catch up should fade and corporate outflows will likely start to normalise boosting outflows. Policy divergence should also come increasingly back into view - all suggesting a weaker yen in H1 2022.

The pace of vaccinations in the EU has picked up sharply and is now showing up in the activity data as the health crisis eases and restrictions are lifted. Relative real interest rate differentials vs the US suggest a firmer EUR over the longer-term. The €750bn NGEU fund is a major prop, encouraging investors to believe that the eurozone is finally getting its fiscal act together, while former ECB president Draghi becoming PM in Italy helps reinforce the eurozone's weakest link. The "feeble fiscal policy" discount, which has weighed on EUR for the best part of a decade, is being been pared and the current account surplus and relatively positive fiscal position vs the US also appeal. We see EUR/USD pushing towards the 1.30 level by mid-2022.

In the short run we see GBP as due a breather after a positive run. The successful vaccine rollout has likely been fully priced in and the exit from lockdown has been very smooth. Very strong growth in Q2 and Q3 is the baseline. However, in the medium term, it looks as if the BoE will be one of the first central banks to hike its policy rate. It will end asset purchases at the end of 2021, which will tighten policy on a relative basis vs the US and the Eurozone. We suspect that once the first hike becomes more visible as 2022 progress, UK short-term rates will rise dragging GBP higher too. We do not see the first hike until 2023 but the Bank's downbeat view on UK supply capacity might drag it forward.



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| FX forecasts (as of 27 May) | Current | End-Q3 21 | End-Q4 21 | End-Q1 22 | End-Q2 22 |
|---|---|---|---|---|---|
| USD/JPY | 109 | 107 | 103 | 105 | 109 |
| EUR/USD | 1.22 | 1.24 | 1.26 | 1.28 | 1.28 |
| GBP/USD | 1.42 | 1.44 | 1.45 | 1.47 | 1.50 |
| EUR/GBP | 0.86 | 0.86 | 0.87 | 0.87 | 0.85 |
| EUR/JPY | 133 | 133 | 130 | 134 | 140 |
| GBP/JPY | 155 | 154 | 149 | 154 | 164 |
| **Bond forecasts (%)** | **Current** | **End-Q3 21** | **End-Q4 21** | **End-Q1 22** | **End-Q2 22** |
| United States | | | | | |
| Policy rate | 0.125 | 0.00~0.25 | 0.00~0.25 | 0.00~0.25 | 0.00~0.25 |
| 2yr | 0.15 | 0.20 | 0.20 | 0.25 | 0.30 |
| 10yr | 1.60 | 1.75 | 1.90 | 1.95 | 2.00 |
| 30yr | 2.28 | 2.30 | 2.30 | 2.40 | 2.50 |
| Eurozone/Bund | | | | | |
| Policy rate/Deposit rate | 0/-0.5 | 0/-0.5 | 0/-0.5 | 0/-0.5 | 0/-0.5 |
| 2yr | -0.66 | -0.65 | -0.60 | -0.55 | -0.50 |
| 10yr | -0.19 | -0.10 | -0.10 | 0.00 | 0.10 |
| 30yr | 0.36 | 0.35 | 0.40 | 0.50 | 0.65 |
| Japan | | | | | |
| Policy rate | -0.1~0.1 | -0.1~0.1 | -0.1~0.1 | -0.1~0.1 | -0.1~0.1 |
| 2yr | -0.13 | -0.10 | -0.10 | -0.10 | -0.10 |
| 10yr | 0.07 | 0.10 | 0.10 | 0.10 | 0.10 |
| 30yr | 0.67 | 0.75 | 0.75 | 0.75 | 0.75 |
| United Kingdom | | | | | |
| Policy rate | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 2yr | 0.05 | 0.10 | 0.15 | 0.20 | 0.40 |
| 10yr | 0.79 | 0.85 | 0.85 | 1.00 | 1.20 |
| 30yr | 1.31 | 1.50 | 1.50 | 1.70 | 2.00 |
| **Macro forecasts (%)** | **2020** | | **2021** | | **2022** |
| United states | | | | | |
| Real GDP | -3.5 | | 6.0 | | 3.3 |
| CPI | 1.2 | | 3.2 | | 2.2 |
| Unemployment rate | 8.1 | | 5.5 | | 4.6 |
| Eurozone | | | | | |
| Real GDP | -6.8 | | 4.3 | | 4.1 |
| CPI | 0.3 | | 1.7 | | 1.3 |
| Unemployment rate | 8.0 | | 8.2 | | 7.9 |
| Japan | | | | | |
| Real GDP | -4.8 | | 2.3 | | 2.8 |
| CPI | 0.0 | | 0.1 | | 0.5 |
| Unemployment rate | 2.8 | | 2.9 | | 2.7 |
| United Kingdom | | | | | |
| Real GDP | -10.2 | | 6.7 | | 4.3 |
| CPI | 0.9 | | 1.6 | | 2.0 |
| Unemployment rate | 4.4 | | 5.3 | | 5.2 |

Source: Bloomberg, Mizuho. Note: GDP, unemployment and inflation figures are annual averages.



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