# Mizuho Global Perspectives

London **30 April 2021**
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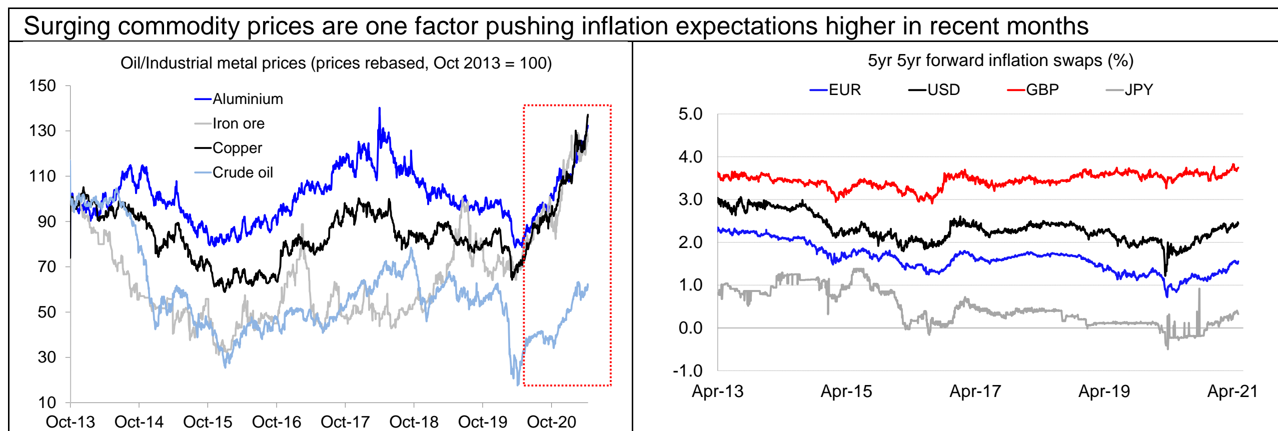
**Forecast update – May 2021**

### Uneven recovery as vaccine rollout, fiscal stimulus vary

The vaccine and the virus remain key elements of the economic outlook, sharing the spotlight with US fiscal policy. The UK and the US are in the vanguard of the vaccine roll out and investors can start to look at what the recovery looks like with more confidence. In the eurozone the vaccine roll out is picking up speed rapidly and Japan, is the laggard on the vaccine front with no sign of any acceleration. In the Eurozone Covid cases numbers look to be coming under control and rapid drop into summer looks possible. Whilst the 4 regions covered in this report look to have the virus under reasonable control, the global case count is rising. As long as the virus remains in widespread circulation, the risks of vaccine-resistant strains emerging remain a potential threat to the global outlook. That said, it seems as if economies are learning to live with Covid, with each successive wave having a relatively less damaging economic impact compared to the previous wave. With Biden's $1.9trn stimulus package passed in full and an infrastructure package in the works, US fiscal policy will prove to be an engine not just for the US but for the global economy, as the US trade deficit rises sharply amid surging demand for imports.

As lockdowns end and demand surges, peak inflation is just around the corner. Recall that it was last April when WTI crude futures briefly traded negative. WTI futures now trade at just under $65/barrel. The impact of energy on the CPI will peak in Q2. In addition, commodity prices have pushed sharply higher over the past 12 months. Other sources of price pressures include shipping costs amid a global manufacturing boom. Many supply chains look stretched. Semi-conductor chips are in short supply too. In addition, it seems likely that in many markets supply and demand will be a little out of kilter as they re-open and this is likely to add to price pressures in some products and probably some services too in coming months. In the short run central banks seem likely to welcome higher inflation after years of undershooting inflation targets and the policy response is likely to be mild to non-existent, as long as expectations remain anchored, which we expect to be the case. That said, a number of QE programmes are scheduled to end late this year or early next and extensions look unlikely and tapering is possible. Monetary policy looks to be passing the point of maximum stimulus

Surging commodity prices are one factor pushing inflation expectations higher in recent months

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## US economy – Stimulus, re-opening to lead to surge in activity in Q2

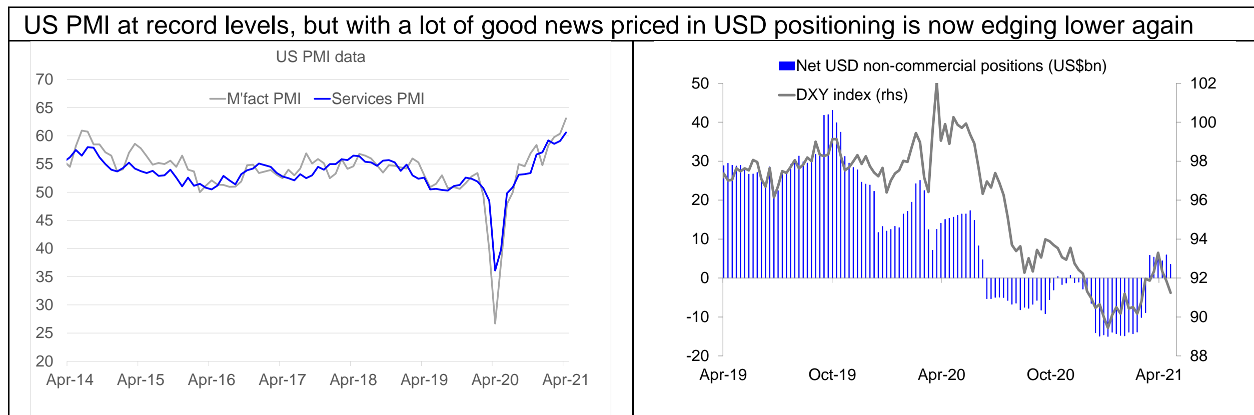
The US economy expanded 6.4%saar in Q1, roughly in line with expectations. Unsurprisingly, the main driver was private consumption as individuals spent their stimulus cheques. At the same time, net exports and especially inventories were a sizable drag. Early Q2 data have been very strong and we see GDP rising 7.0% saar in Q2. We look for the economy to push past its pre-Covid peak during the second quarter. The US fiscal response to the Covid crisis has been very large, most notably via support for incomes, which are well ahead of the pre-Covid trend. How rapidly Americans run down their Covid savings will have a major impact on the outlook. The improvement in the labour market is likely to be rapid in coming months but should slow in H2. 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-late 2022. Base effects and bottlenecks are likely to push headline inflation temporarily above 3.0% in mid-2021, although core rates are likely to lag.

### Policy – Fiscal policy to be highly stimulative, monetary policy to be highly stimulative

The fiscal side of the US policy mix remains the key focus for investors given the scale of Biden's plans. The infrastructure packages will be mainly 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. Fed Chair Powell is doing his best to underscore the Fed's commitment to Average Inflation Targeting and allowing the economy to run hot. At the April meeting Chair Powell noted that it was too early to talk about talking about tapering and stressed the Fed's multi-faceted labour market goals. He also noted base effects and bottlenecks were mainly temporary factors, stressing that wage-driven inflation is what the Fed is looking out for. We do not expect that any pickup in inflation will appear sustained enough to trouble the Fed. Indeed, some inflation would be welcome. By end 2021, we see Fed policy unchanged in terms of the policy rate and the pace of bond purchases, but expect that 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 should push longer-dated yields higher in H1. We see 10yr UST yields ~1.75% by summer and then little changed in H2.

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# Eurozone economy – Vaccine progress accelerating, good times ahead

The Eurozone economy contracted 0.6%QoQ in Q1, much less than seemed likely a few months ago, suggesting that like other economies, the Eurozone is learning to better cope with the Covid crisis. Despite the increase in restrictions at the start of Q2, the increasingly rapid roll out of the vaccine means the recovery is increasingly assured. The April survey data have been pretty upbeat, despite the restrictions, and we expect to see further improvements in May and June. We see Q2 GDP rising 1.5%QoQ and even faster growth in Q3. We push our annual 2021 GDP forecast up to 4.3% from 3.8% reflecting the better start to the year. That said, some of the upgrade comes at expense of the 2022 forecast, which is pushed down to 4.1% from 4.4%. The EU will see vaccine supply roughly triple in Q2, after a difficult Q1. Around 23% of the EU population has been vaccinated with at least 1 dose - a significant improvement over the last month. 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 technically driven. Recent 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 just over 1% in 2022.

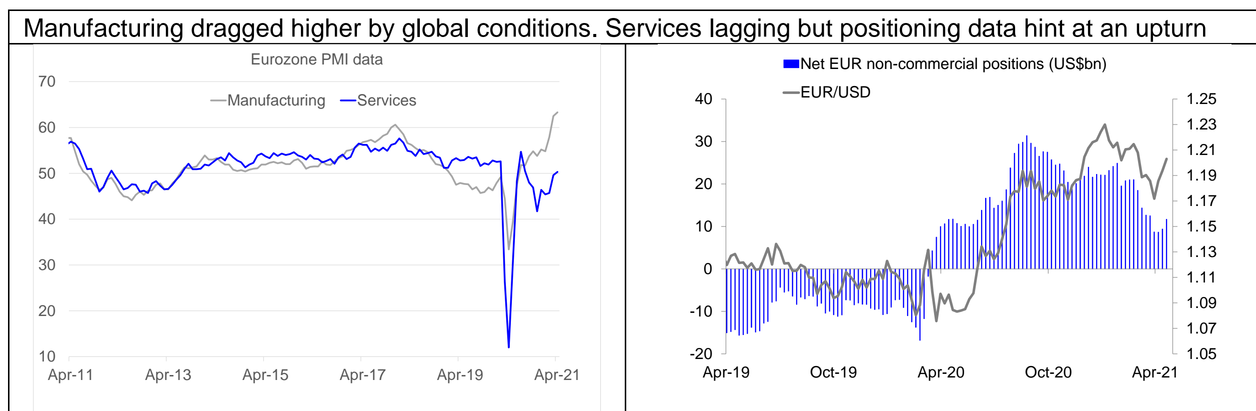
**Policy – National fiscal policy taking up any slack. ECB picks up the PEPP pace**

At its April meeting, the ECB left policy unchanged. President Lagarde said little new at the press conference and the focus shifts to the June meeting where the hawks and doves are likely to do battle on the pace of PEPP. We expect asset purchases at the current pace through the remainder of H1 21 and then a slowing in H2, as the recovery finally strengthens. We expect the bulk of the PEPP envelope to be used and the programme to end in March as scheduled. The ECB seems to have shifted its focus to financial conditions, which remain considerably tighter than in the US, in part due to the weaker performance of European equity markets. The EU fiscal pact is likely to remain suspended at least until 2022 giving individual countries scope to support the recovery. Italy is the major focus on the fiscal front. With Draghi having pushed his programme, which includes the spending of funds from the EU package, through parliament the focus switches to implementation.

**Rates – Short end pegged. Longer end yields to push higher near term**

Policy rates seem unlikely to change any time soon. Short-term bond yields look to be pegged. At the long end we see some of the curve steepening pressures in the US seeping into Eurozone bond markets pushing Bund yields higher into summer.

Manufacturing dragged higher by global conditions. Services lagging but positioning data hint at an upturn

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## Japanese economy – Slow vaccine roll out, slow recovery

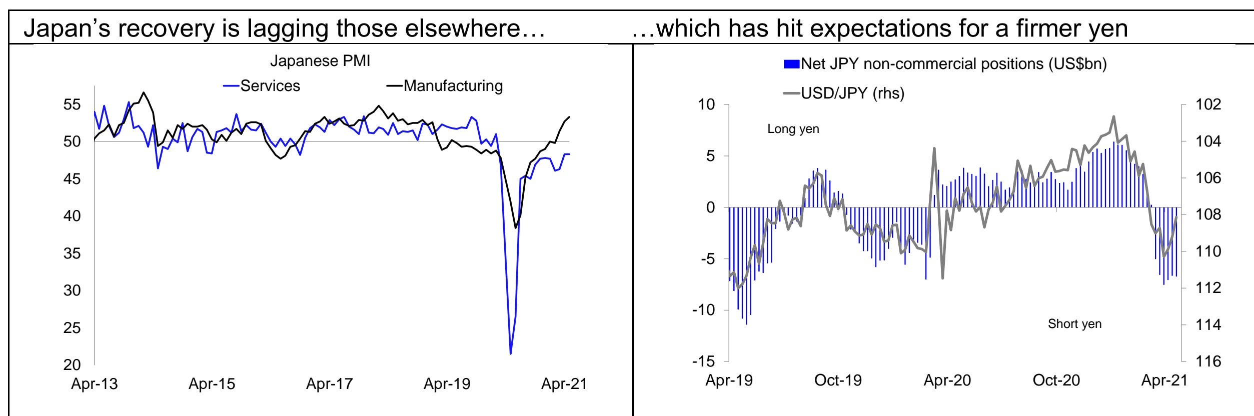
Recent data have been better than expected and there are upside risks to our Q1 GDP forecast for a 1.0%QoQ drop. However, with the state of emergency being quickly re-imposed, there are growing downside risks to the Q2 forecast. This new state of emergency only lasts until 15 May and only covers 4 (economically important) prefectures but will still knock a little off Q2 GDP and delay the recovery. The vaccination programme is underway but remains too slow to have much impact on activity. The Olympics will go ahead as planned but overseas spectators will not be allowed. The Games should help boost consumer sentiment even if the boost from inbound tourism is missing. Our 2021 GDP forecast remains at 3.2%. The rising virus count has hit government popularity and the Lower House election is now likely to be held as late as possible. Suga is hoping that the vaccine, a recovery and a solid Olympics will see him retain the LDP presidency in the September contest and thus remain PM into and beyond the Lower House election, as the governing coalition are highly likely to win. Changes to mobile phone charges may push headline CPI lower by as much as 0.5pp from spring. 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.

**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 if required, 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, with lower ETF purchases and a slightly wider range for 10yr yields the outcome. 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 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 – Vaccine progress good. Recovery on track

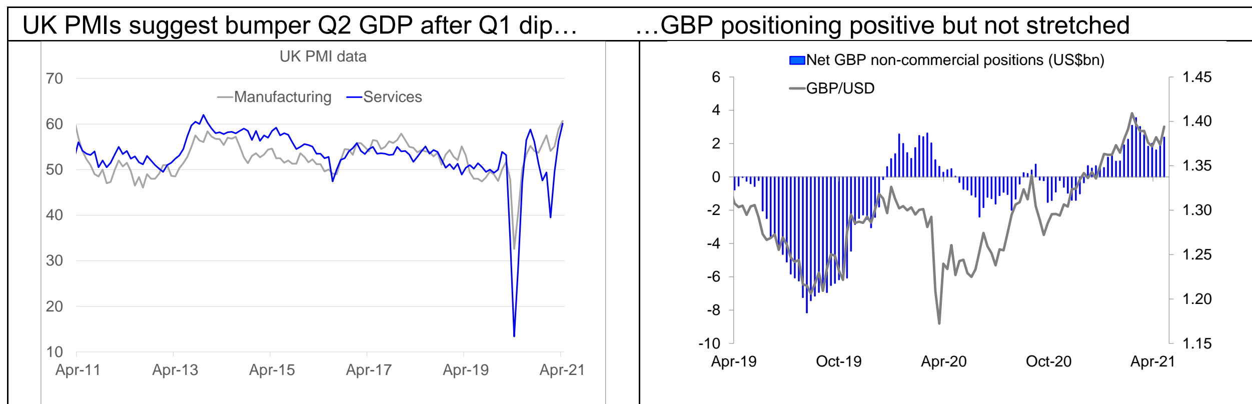
The UK is rapidly emerging from lockdown as the Covid case count plunges amid significant progress on the vaccination front. Over 50% of the population has had at least one dose, with 20% fully vaccinated. The route out of lockdown remains on track and the economy is responding well. The standout data release of the last month is the 5.4%MoM surge in retail sales in March, with sentiment indicators surging too. Q1 GDP is certain to be negative, but the rebound in Q2 is already baked in. We see Q2 GDP rising over 4%QoQ. We push our 2021 GDP forecast up from 5.0% to 6.0% but 2022 down from 5.2% to 4.7% - mostly a faster rather than a stronger recovery. Note we still see it taking to mid 2022 before UK gets back to pre-Covid levels. The 2020 drop was precipitous. The CPI should pick up from spring as VAT cuts drop out of the annual comparison and the contribution from energy prices turns positive. There is likely to be some mild, short-term Brexit/pandemic impact on prices too. Inflation is likely to push above target by end 2021 only to ease again in 2022 as the energy price impact turns less positive. 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 – Fiscal policy a little looser than expected near term. BoE on hold for 2021 but taper is coming**

The BoE is relaxed about the impact of higher yields, seeing them as a sign of optimism on the recovery. The BoE's asset purchase programme will run out in September at the current pace. The Bank has said it will slow the pace of purchases at some stage, likely mid-year, implying an end point nearer year end. Easing looks to be off the table in the absence of a vaccine-resistant Covid strain emerging. The May BoE meeting could see an upgrade to activity forecasts but underlying price pressures remain subdued, with the output gap still wide. With Andy Haldane retiring after the June meeting the most vocal hawk is leaving the Committee. Until we know more about his replacement, this is a win for the doves. The budget, which contained investment incentives for companies in the short-term balanced against tax increases in the longer term, provides a minor boost to demand in 2021, is more or less neutral in 2022 and will weigh on demand in 2023 and beyond.

**Rates – Gilts …GBP in neutral as vaccine lead ebbs**

2yr Gilt yields will likely remain in positive territory, even though they are unlikely to rise far from current levels given no prospect of a rate rise any time soon. Longer-term UK yields could nudge a little higher as the recovery firms, but as with the currency there is a decent amount of good news priced in and the UK's vaccine lead is already fading.

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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, despite awesome data in April, 10yr UST yields pushed lower over the month, taking the steam out of the USD rally. Inflation fears are overdone 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 be pushed back too. 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. This is likely to get worse in coming quarters. These conditions suggest to us the US dollar will remain under modest pressure through end 2021.

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 heavily and for portfolio outflows to remain subdued in 2021. Corporate outbound FDI and M&A activity will also remain subdued as companies prioritise survival/liquidity over expansion and foreign adventures for much of the year. The pressure from the current account surplus should remain in place, helping the yen to pare its undervaluation, as should elevated real interest rates. The yen is currently one of the cheaper G10 currencies and the cheapest safe haven. We look for the yen to strengthen modestly in 2021, with USD/JPY heading back towards the 100 level by year end.

The EU's vaccine underperformance is coming to an end. The recent pace of vaccinations has stepped up sharply and is likely to start showing up in the activity data in coming months 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 Recovery and Resilience 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 1.25 level by end 2021.

The shine is starting to come off GBP after a very strong start to the year, as the successful vaccine rollout has now been fully priced in. With the exit from lockdown looking smooth negative rates no longer seem likely. Negative Q1 GDP growth will be overlooked amid a focus on a firm recovery. Very strong growth in Q2 and Q3 should help support GBP vs USD. We do not see the Scottish elections in May as a threat to GBP, mainly due to the fact that we suspect that PM Johnson would initially refuse to grant a referendum. Longer-term, any political negatives for GBP resulting from Scottish independence would likely be offset by economic positives for the remainder of the UK, mainly due to lower fiscal costs.



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| FX forecasts (as of 30 April) | Current | End-Q2 21 | End-Q3 21 | End-Q4 21 | End-Q1 22 |
|---|---|---|---|---|---|
| USD/JPY | 109 | 109 | 106 | 103 | 100 |
| EUR/USD | 1.21 | 1.23 | 1.24 | 1.25 | 1.26 |
| GBP/USD | 1.39 | 1.38 | 1.39 | 1.40 | 1.42 |
| EUR/GBP | 0.87 | 0.89 | 0.89 | 0.89 | 0.89 |
| EUR/JPY | 132 | 134 | 131 | 129 | 126 |
| GBP/JPY | 152 | 150 | 147 | 144 | 142 |
| **Bond forecasts (%)** | **Current** | **End-Q2 21** | **End-Q3 21** | **End-Q4 21** | **End-Q1 22** |
| United States | | | | | |
| Policy rate | 0.00~0.25 | 0.00~0.25 | 0.00~0.25 | 0.00~0.25 | 0.00~0.25 |
| 2yr | 0.17 | 0.20 | 0.20 | 0.25 | 0.30 |
| 10yr | 1.63 | 1.75 | 1.70 | 1.80 | 1.90 |
| 30yr | 2.29 | 2.40 | 2.30 | 2.30 | 2.50 |
| Eurozone/Bund | | | | | |
| Policy rate/Deposit rate | 0/-0.5 | 0/-0.5 | 0/-0.5 | 0/-0.5 | 0/-0.5 |
| 2yr | -0.69 | -0.65 | -0.65 | -0.60 | -0.55 |
| 10yr | -0.20 | -0.20 | -0.10 | -0.10 | 0.00 |
| 30yr | 0.35 | 0.35 | 0.35 | 0.40 | 0.45 |
| 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 | 0.09 | 0.10 | 0.10 | 0.10 | 0.10 |
| 30yr | 0.65 | 0.70 | 0.75 | 0.75 | 0.75 |
| United Kingdom | | | | | |
| Policy rate | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 2yr | 0.07 | 0.10 | 0.10 | 0.10 | 0.15 |
| 10yr | 0.83 | 0.85 | 0.80 | 0.75 | 0.80 |
| 30yr | 1.34 | 1.50 | 1.40 | 1.40 | 1.40 |
| **Macro forecasts (%)** | **2020** | | **2021** | | **2022** |
| United states | | | | | |
| Real GDP | -3.5 | | 5.5 | | 3.5 |
| CPI | 1.2 | | 2.4 | | 2.1 |
| Unemployment rate | 8.1 | | 5.5 | | 4.6 |
| Eurozone | | | | | |
| Real GDP | -6.8 | | 4.3 | | 4.1 |
| CPI | 0.3 | | 1.6 | | 1.2 |
| Unemployment rate | 8.0 | | 8.3 | | 7.8 |
| Japan | | | | | |
| Real GDP | -4.8 | | 3.2 | | 2.2 |
| CPI | 0.0 | | 0.1 | | 0.5 |
| Unemployment rate | 2.8 | | 3.1 | | 2.8 |
| United Kingdom | | | | | |
| Real GDP | -10.2 | | 6.0 | | 4.7 |
| CPI | 0.9 | | 1.5 | | 1.9 |
| Unemployment rate | 4.4 | | 6.0 | | 5.5 |

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


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