Schroders

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Economic and Strategy Viewpoint

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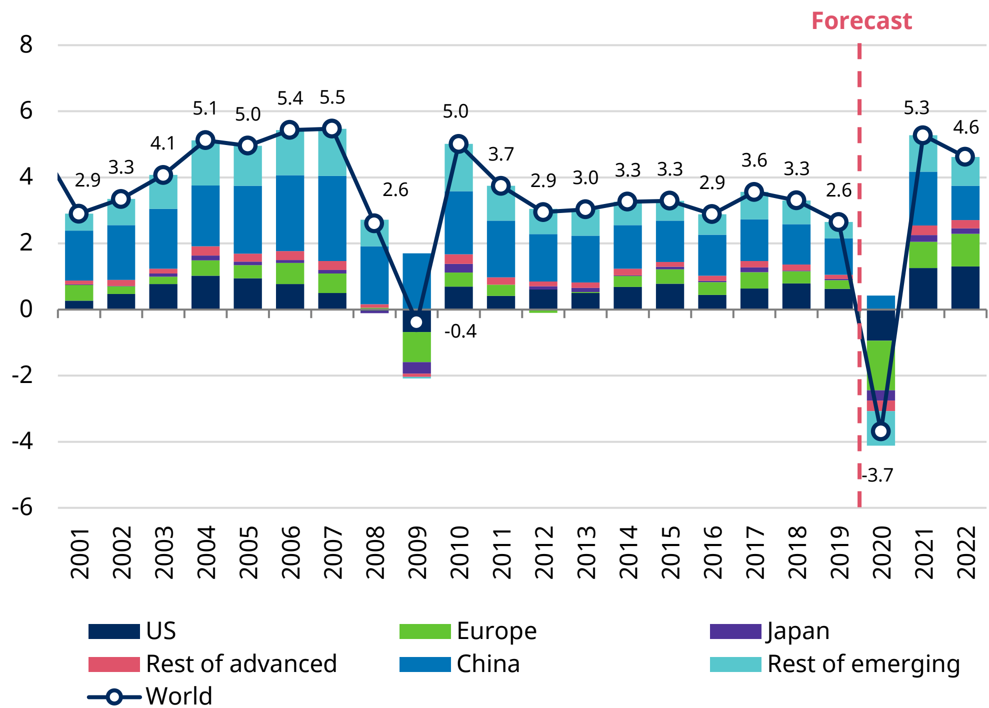
Forecast update: will doves cry?

- We have upgraded our forecast for global growth over the next two years with the main change being seen in 2022 when economies will have more fully normalised and fiscal and monetary policy remains loose. For this year, upgrades to the US, UK, Japan and some emerging economies are largely offset by a hefty downgrade to the eurozone to leave our global growth forecast little changed.
- Inflation remains a persistent worry for investors, but we continue to see the forthcoming pick up as temporary: driven by commodity price base effects with little prospect of the second round developments which would create a problem for the US Federal Reserve (Fed) and other central banks. Inflation will rise more persistently when the output gap closes in the second half of 2022.
- We believe that there is sufficient slack in the world economy to absorb a strong initial rebound in global demand as economies re-open. Nonetheless a dovish Fed will need a cool head in coming months as inflation rises and it communicates its new policy framework to investors. An inflation-led market sell-off is a risk scenario.
- Our other scenarios include a more reflationary outcome with less scarring and stronger fiscal multipliers and a return of trade wars with stagflationary consequences. Meanwhile, the 'vaccine fails' and 'China hard landing' make up our deflationary risks.

Chart: Contributions to global growth



Source: Schroders Economics Group, 20 February 2021. Please note the forecast warning at the back of the document.

Forecast update: will doves cry?

Extra fiscal stimulus brings upward revision to global GDP forecast as vaccine roll-out continues

The Democrat sweep and President Biden's announcement of a $1.9 trillion stimulus bill (the American Rescue Plan, ARP) has led us to upgrade our forecast for US GDP growth with a knock-on effect to the rest of the world. We now expect US GDP to increase 4.7% this year and 4.9% next, an upgrade of just over 1 percentage point for both periods. The rest of the world benefits through stronger trade and the impact is most noticeable in our 2022 global growth forecasts which are raised from 4.1% to 4.6% as the world economy normalises.

For 2021, stronger US fiscal policy helps, but at the global level the gains are largely offset by a significant downgrade to our Eurozone growth forecast from 5% to 3.5% as a result of an extended lockdown and a slow vaccine roll-out. Meanwhile, despite also experiencing an extended lockdown, UK growth is upgraded slightly to 5.3% assisted by a successful vaccine roll-out. Japan and the emerging markets are also upgraded, but the net result is that our global growth forecast is only marginally stronger for 2021 at 5.3%.

Alongside higher growth comes increased inflation, largely driven by higher oil and commodity prices. We now expect global consumer price inflation to rise 2.6% this year (previous forecast 2.2%) before easing back to 2.4% in 2022. Given current concerns, the moderation next year is critical for policy and financial markets, and we discuss further below. Overall, the forecast moves in a more reflationary direction with stronger growth and higher inflation than in our last forecast in November.

To put the growth outlook in context, after a fall in global GDP of nearly 4% in 2020 we expect one of the strongest recoveries on record for the world economy, beating the rebound from the global financial crisis (GFC) in 2009-10 (see chart front page).

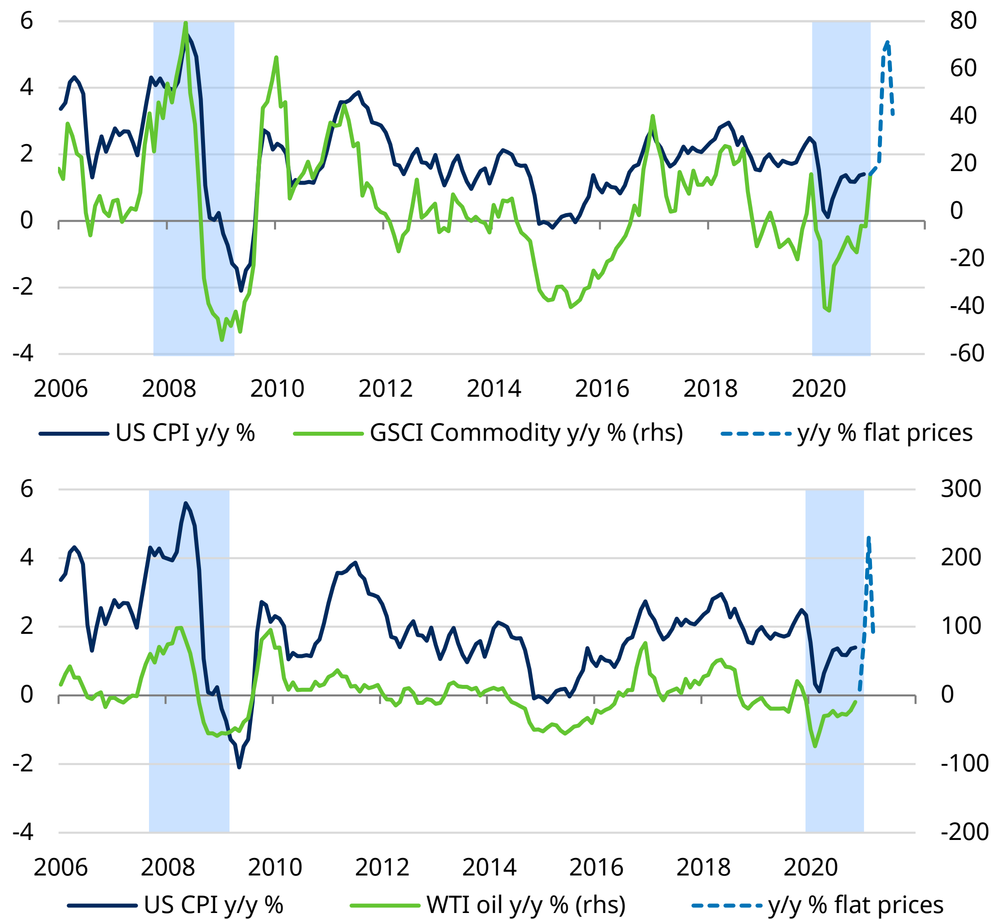
There is an elastic band effect here with the key driver being a hand-over from the industrial sector, which has supported growth so far, to the service sector as the vaccine brings a degree of normalisation and the re-opening of this significant part of the economy.

One consequence is that the coming recovery is expected to be driven more by the service-dependent advanced economies than after the GFC. It is also the case that compared with ten years ago, the emerging economies do not have the benefit of an enormous fiscal boost from China and, with less access to medical care and vaccines, are more challenged by the pandemic than their wealthier neighbours.

A new inflationary era?

Concerns are increasing that we are now entering a new inflationary era and we do expect headline consumer price indices to pick-up sharply in coming months as powerful base effects feed through. For example, West Texas Intermediate (WTI) oil prices will be some 200% higher versus March 2020 and food prices are also up year-on-year as captured by the broader S&P GSCI index (chart 1).

Chart 1: Commodity prices to drive inflation spike

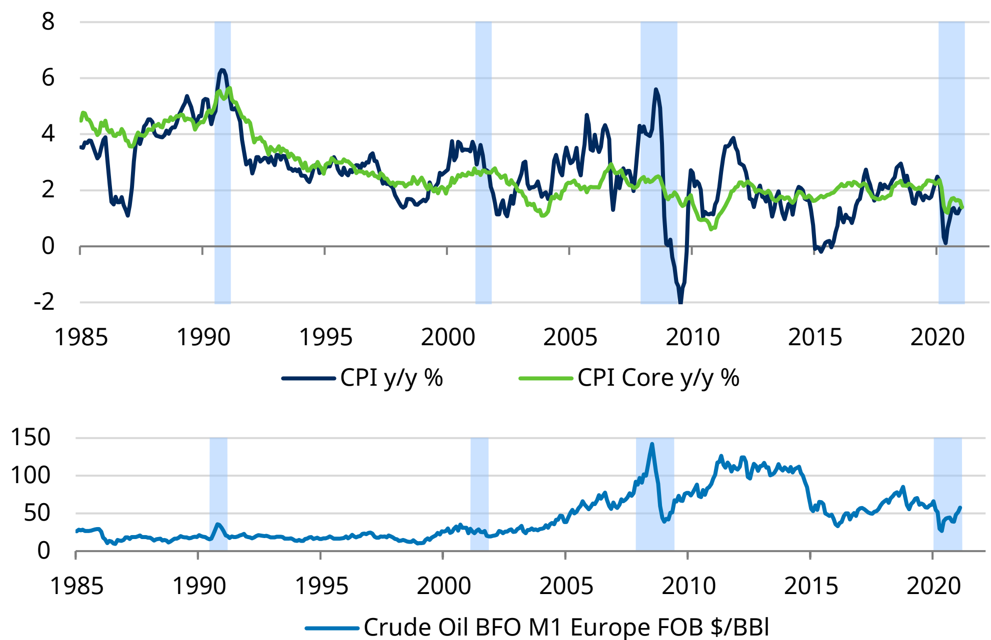


Source: Refinitiv, Schroders Economics Group, 17 February 2021.

Commodity prices to cause temporary inflation spike

The picture is similar to a decade ago when oil and food prices spiked and pushed US headline inflation over 5%. However, core inflation (Consumer Price Index, CPI excluding food and energy) did not increase and once commodity prices had stabilised headline inflation fell back significantly (chart 2).

Chart 2: US inflation and oil prices



Source: Refinitiv, Schroders Economics Group, 17 February 2021.

We are expecting a similar pattern this time with headline US CPI inflation rising to 3.5% in Q2 before falling back as the base effect washes through. Unless one-off price shocks feed through into wages and a broader rise in costs, the impact on inflation will be temporary. Our view is that the economy has spare capacity and can absorb the increase in demand without causing a second round of price increases. Inflation tends to decline after recessions and during recoveries as firms get back to work and use the slack created by the downturn to raise output (chart 2). Productivity strengthens and unit labour costs fall allowing companies to keep prices competitive.

As a consequence, we see US and world inflation falling back later on in 2021 and into 2022. The time for a more sustained pick-up in inflation will come in the second half of next year when we estimate that the output gap will have closed in the US and economic slack will have been largely used up. Although there are pressures on prices in specific sectors at present it is too early in the cycle to see inflation taking off.

Near-term risks to inflation

We use our scenarios to explore higher inflation risks over the next two years below, but in the near term we would highlight two additional risks to our dovish view.

One is on pricing once lockdowns are lifted. Bringing the service sector back will add to capacity, but it may still be restricted. Consequently businesses may find their productivity hampered by limits, for example on the number of people allowed in a shop, café or restaurant at any one time. There will also be costs incurred in re-opening. By contrast, other sectors such as travel and airlines have said they will cut prices to bring customers back. Business investment held up relatively well during the downturn, indicating that firms are keen to have capacity when demand returns. The outcome in the near term is unknown and is made more complicated by the fact that during the lockdowns it has been difficult to measure prices in the service sector as many firms have been effectively closed.

High savings and stimulus cheques will boost demand, but by how much?

The second risk is on the demand side. Inflation bears argue that the surge in demand on re-opening will be so great that prices will increase faster and inflation will be persistently higher. Concerns centre on the amount of pent-up demand in the US economy where an anticipated run-down in personal sector savings and further fiscal stimulus from President Biden's ARP will boost demand faster than the economy can re-open.

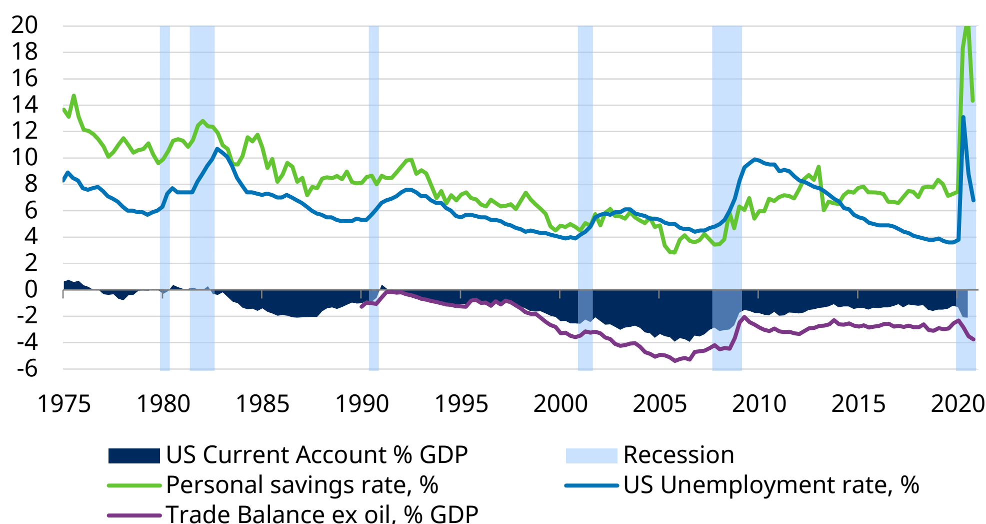
It is certainly the case that if US households ran down their savings completely on re-opening there would be inflation as $1.6 trillion of cash hits the economy. In practice this is likely to be spread out. Much of the increase in savings is concentrated in higher income households with a lower marginal propensity to consume whilst scarring effects mean people will be cautious about returning to normal behaviour particularly given new variants of covid. We also see a post-covid economy where there is more working from home and less travelling, resulting in a restructuring of much pre-covid activity creating uncertainty and unemployment.

Gauging the fiscal boost

On the fiscal side, President Biden's ARP is passing through Congress at present and we assume just over half of the $1.9 trillion gets through. However, as with any fiscal package the degree to which it boosts growth will depend on how much is actually spent rather than saved or used to buy imported goods from overseas. Such 'leakages' reduce the fiscal multiplier and dampen the boost from tax cuts or spending increases. We have already seen these effects at work following the earlier CARES package: the personal savings rate shot up and imports rose after stimulus cheques arrived in bank accounts. The result was that alongside a rise in the savings rate we saw a sharp deterioration in the trade and current account deficit as US demand spilled overseas, dampening the domestic boost (chart 3).

Chart 3: US fiscal boost triggers rise in savings and trade deficit

Pandemic has exacerbated inequality and the task of reaching maximum employment



Source: Refinitiv, Schroders Economics Group, 15 February 2021.

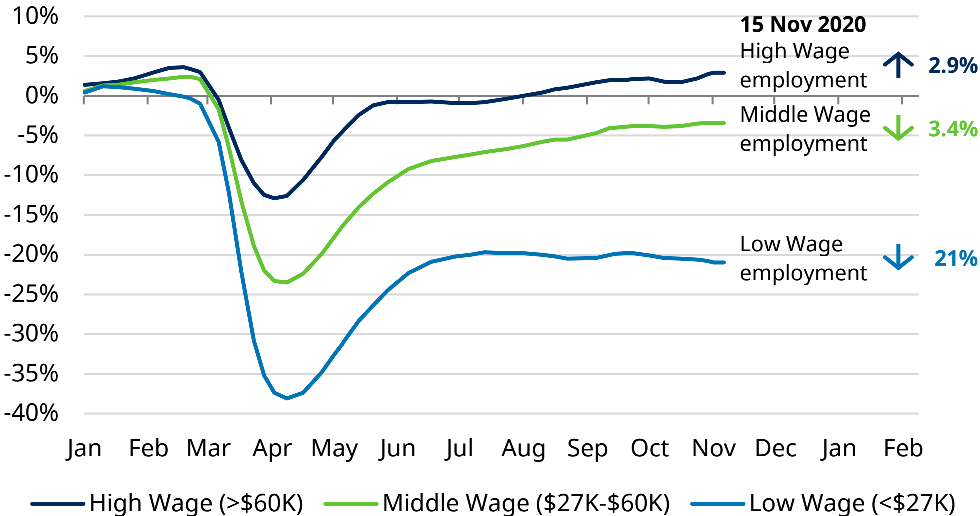
We would expect to see a similar pattern play out in coming months with the savings rate rising again and the trade deficit widening significantly. Oxford Economics use a multiplier of 0.35 cents/$ in 2021 for the ARP. The fiscal boost will be strong, but only around one third of the headline figure will feed into domestic output.

Fed policy

The focus on inflation is understandable as it could undermine one of the key supports for the market: loose monetary policy. The US Federal Reserve (Fed) has maintained a dovish stance and has made great efforts to dispel the notion that it is about to end, or taper, its asset purchase programme (QE). The taper tantrum of 2013 still weighs on the US central bank. The coming rise in headline inflation will test its resolve further, but we have to remember we are dealing with a new policy framework where there is scope for inflation to run above 2% for a period.

Average inflation targeting is designed to avoid the persistent undershoot of core inflation seen over the past decade. There is also the requirement to reach maximum employment and although the Fed has not been specific about how this should be defined, Chair Powell has indicated it goes beyond the narrow U3 measure of unemployment. There is a strong desire to see the benefits of economic growth spread more widely to low paid and minority workers, and Powell has pointed out that the economy is still down by 10 million jobs compared to where it was before the pandemic. Judging by the disproportionate impact of the pandemic on lower paid workers where employment rates are down by a fifth, there is much to be done before maximum employment is reached (chart 4).

Chart 4: US employment by income



Source: tracktherecovery.org, Schroders Economics Group. 18 February 2021.

On this basis we do not see the Fed raising rates during the forecast period and probably not before end-2023. We do expect a gradual scaling back of QE before then with the purchase of bonds being reduced from its $120billion/month rate in Q2 next year.

We explore the risks around the baseline below, but first look in more detail at the regional forecasts.

Regional views

Europe's growth downgraded

Owing to the more restrictive and longer pandemic-related lockdowns, the forecast for Europe has been downgraded for this year. Real GDP is still forecast to rise from the record drop of -6.8% in 2020, but to only 3.6% for 2021, compared to the previous forecast of 5% (table 1).

Europe downgraded as lockdowns return

Table 1: Schroders GDP forecast for Europe

	2020	2021			2022		
Eurozone	-6.8	3.6	↓	(5.0)	4.8	↑	(4.1)
Germany	-5.3	2.7	↓	(4.8)	4.9	↑	(4.5)
France	-8.3	4.0	↓	(5.7)	4.7	↑	(3.5)
Italy	-8.9	4.1	↓	(5.3)	4.8	↑	(3.9)
Spain	-11.0	5.4	↓	(6.5)	6.6	↑	(6.4)
UK	-9.9	5.3	↑	(5.0)	5.1	↑	(4.5)

Source: Eurostat, ONS, Refinitiv, Schroders Economics Group. 17 February 2021.

As the number of confirmed cases and deaths continued to rise towards the end of last year, most member states tightened restrictions. For example, in mid-December, Germany decided to close schools and non-essential retail, with the latest plan to only open from the start of March.

The good news is that restrictions have so far had a far smaller impact than was recorded at the start of the pandemic. Eurozone GDP only contracted by 0.6% in the final quarter of 2020, while Germany managed to eke out 0.1% growth. This should mean that even with tougher restrictions, only a moderate fall in growth should be seen in the first quarter, followed by a solid rebound as economies open up.

There are, however, some significant risks. The roll-out of vaccines has been woeful compared to other advanced economies. According to ourworldindata.org, those in the European Union that have received a single vaccine dose make up just 5% of the population as of 15 February. Significantly behind the US at 16% (14 February) or the UK at 23%.

Another risk is the apparent reluctance to take up vaccines. Recent polling flagged the French population as being one of the most sceptical, which suggests that even with the approval and supply issues resolved, poor take-up may mean that herd immunity is not achieved. This raises the risk of our 'vaccine fails' scenario, but specifically for Europe, as member states are forced to re-introduce lockdowns in winter 2021/2022.

Slow vaccinations in Europe and public reluctance have raised the risk of further lockdowns

The restrictions appear to be working as the numbers of cases and deaths are falling. However, the delays in vaccinating the population could mean that Europe misses out on the lucrative tourism season this summer, as it largely did last year. Indeed, 2021 could potentially be even worse, as travel restrictions have been tightened. Southern member states, especially Spain, could see their recoveries lag behind others, at least until 2022.

The Eurozone growth forecast for 2022 has been revised up from 4.1% to 4.8%, as by then, not only should restrictions on activity have been fully removed, but the impact of fiscal stimulus measures should be seen. Investment in green initiatives and digital infrastructure is being given priority, but there is bound to be leakage to other parts of the economy.

The forecast for inflation has been revised higher, largely due to the rise in wholesale oil and gas prices, but also due to the downgrade of the euro versus sterling. Headline HICP (Harmonised Index of Consumer Prices) inflation is expected to rise to above 2% by the end of 2021, but fall back over 2022 to average 1.2%. Core inflation, excluding food, alcohol, tobacco and energy, should average 1.1% this year, before climbing up to 1.5% in 2022. The rise in core inflation is related to tax cuts falling out of the annual comparison and the lagged impact of administered prices, rather than any material rise in pricing power. This helps keep monetary policy ultra loose, with asset purchases as part of the European Central Bank's quantitative easing programme continuing throughout the forecast, and interest rates kept on hold.

The UK's vaccine success

The UK's success so far in the speed of vaccinating its population will help lift restrictions faster, and aid its economic recovery. Despite pandemic-related restrictions continuing for longer than previously expected, real GDP growth has been upgraded for 2021 – from 5% to 5.3%. The first quarter of the year is likely to see a larger contraction than previously expected, but a rebound in activity should more than offset this in the following quarters.

UK growth upgraded thanks to improved business confidence and household spending

Growth for 2022 has also been revised up, from 4.5% to 5.1%. This is partly due to improved businesses confidence, which should help lift capital spending (capex) as spare capacity is utilised, but also driven by an upward revision to our estimate of household savings, which provides more room for a spending recovery.

As we await the government's next fiscal statement, we doubt there will be much in the way of austerity in the next couple of years, though pandemic-related spending should naturally fall off.

As with other regions, inflation has been revised up for this year. However, due to the upgrade to sterling, the impact from higher oil prices is partially offset. Consequently, CPI has only been nudged up by 0.1 percentage point to 1.8% for 2021. Inflation in 2022 has been revised down from 2.1% to 1.5%, as energy inflation rolls off.

As for monetary policy, the low inflation environment should be helpful for growth, though monetary conditions have tightened recently. Market expectations of negative interest rates have been priced out as the Bank of England (BoE) largely ruled out the move in the near term. This has caused bond yields to rise. In addition, the recent appreciation in sterling is contributing to tighter conditions, which the BoE is likely to want to offset. As a result, we maintain our forecast for interest rates to be kept at 0.1% throughout the forecast horizon. However, we are likely to see an end to the BoE's quantitative easing programme, with current purchases due to end this year. It would be difficult to explain why it should be extended into 2022 if the economy is booming as it is forecast to do.

Japan

As a beneficiary of demand from the US, fiscal stimulus should boost exports and replace the domestic demand we envisaged before

As a key beneficiary of the strong demand in the US and China, our view continues to be that Japanese growth will outperform expectations this year and next.

We upgrade our forecast for GDP growth to 3.2% in 2021 and make a few changes to the profile and drivers of growth. Firstly, renewed restrictions on social activity will cause growth to slow in the first quarter. Secondly, Japan has been given the green light on the vaccine later than we had anticipated. So we delay our expectation of the re-opening of the service sector and push out the improvement in consumption into next year. Finally, fiscal stimulus from the US should boost export demand and help to replace the domestic demand we envisaged before. As a result, we upgrade 2022 to 2.5% for the year as a whole.

We raise our forecast for inflation to 0.3% this year, predominantly due to higher energy prices. Inflation should now turn positive in coming months and core inflation, though likely to stay weak, should improve in the second half of the year as travel subsidies are rolled back and growth picks up. Enhancing the sustainability of its yield curve control policy, we now expect the Bank of Japan (BoJ) to allow more flexibility in the 10-year Japanese Government Bond (JGB) yield target. This should allow a faster tapering of purchases of JGBs along with exchange-traded funds (ETFs), which the BoJ have also hinted at doing. Factoring in the wider asset purchase programme, the balance sheet should still rise.

The latest deterioration in Prime Minister Suga's approval ratings now means there is a high chance that he will not gain the support from his party needed to continue after September. This could slow down the reform agenda and mark a change for investors, who, for some years, have been used to Japan as source of political stability.

Emerging markets

Strong rebound as growth baton passes from Asian exporters to the rest of EM

We continue to expect emerging market (EM) GDP to expand by about 7% this year, following an expected contraction of 1.6% in 2020. Our expectation for significant fiscal stimulus to be delivered in the US at a time when vaccines will be rolled out around the world means that we have nudged up our forecast for GDP growth next year to 5%. That leaves us above the consensus forecast for growth of 6.5% and 4.7% this year and next.

There is likely to be some rotation in the drivers of EM growth during the year. In the near term, export-orientated economies in Asia should continue to fare relatively well on the back of strong demand for manufactured goods. This cyclical recovery is likely to fade during the course of this year as inventories are replenished, passing on the growth baton to other economies which will benefit more from the eventual roll-out of vaccines.

A temporary increase in inflation driven by higher food and energy costs is likely to put pressure on many EMs' bond markets, especially at the short end of the yield curve in the months ahead. This looks set to force Brazil's central bank to start raising interest rates from extremely low levels in the first half of the year. However, most EM central banks should be able to ride out the storm, instead focusing on the long-term deflationary drag caused by the spare capacity left from last year's recession. The greatest risk of surprise rate hikes is in Central Eastern Europe and parts of Asia.

China

China to register extremely strong growth in Q1, but leading indicators are rolling over

After being one of the few economies in the world to grow in 2020, China looks set to remain at the top of the growth charts this year with an expansion of about 9%. However, the annual rate of expansion will be flattered by strong base effects that look set to lift GDP growth towards 20% year-on-year (y/y) in the first quarter. The bigger picture is that underlying, quarter-on-quarter rates of growth have already begun to normalise while leading indicators such as the credit impulse, real M1 and manufacturing purchasing manufacturer's indices (PMIs) have begun to roll over consistent with a peak in the cyclical recovery in mid-2021.

Chart 5: China's credit impulse appears to be rolling over

Source: Bloomberg, Refinitiv Datastream, Schroder Economics Group. 12 February 2021.

Activity is not about to collapse and resurgent growth in developed markets will bolster demand for manufactured goods. But with the authorities withdrawing policy stimulus we expect China's economy to resume its trend slowdown in the second half of this year and into 2022, when we expect GDP growth of 5.7%.

India

We upgrade the growth outlook in 2022 as India relaxes fiscal prudence

India has perplexed investors by escaping a second wave of the coronavirus and the economic recovery is progressing faster than forecasters, including ourselves had anticipated. Several activity indicators suggest India is now growing on a year-on-year basis. Following an expected 7.3% y/y contraction in 2020, we expect India to grow strongly year at 11% y/y, led by a cyclical recovery in consumption and investment. However, a structural upswing in investment is still unlikely as credit growth remains subdued. Nonetheless, we upgrade our growth forecast for 2022 to 7%, reflecting the relaxation in fiscal prudence from the Indian government in the latest budget. We expect inflation to fall from 6.6% to 4.7% this year as food prices come down. But well above potential growth is likely to cause some underlying inflationary pressure in 2022. As a result, we now see the Reserve Bank of India (RBI) raising rates by 50bps in the second half of next year. Though in the coming months, the RBI will likely help to absorb additional government bond issuance through open market operations.

Brazil

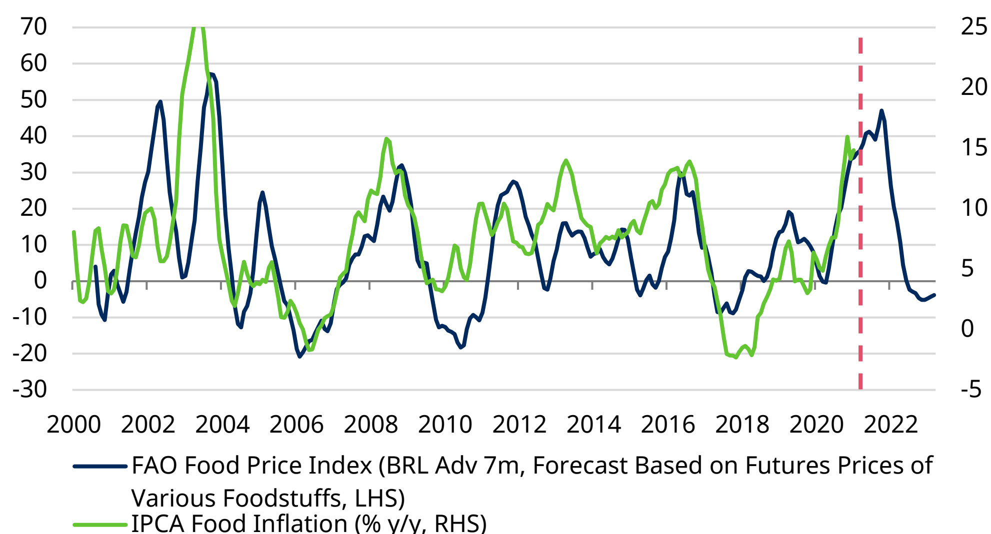
Growth likely to undershoot expectations as higher inflation forces interest rates higher

The strong rebound in Brazil's economy during the second half of 2020 began to fizzle out towards the end of last year. Indeed, a contraction in retail sales in December and decline in the composite PMI to 48.9 in January suggests that the economy could contract in the first quarter of 2021. This is something that we had already factored into our forecasts and is now becoming a more consensus view.

The economy should return to growth once these distortions from the covid crisis have passed, and the large services sector will eventually benefit from the roll-out of vaccines that is now underway. However, the need for fiscal consolidation and high unemployment is likely to lead to a relatively subdued recovery. We forecast below-consensus growth of 2.8% this year and 2.5% in 2022.

Another factor that looks set to weigh on the recovery is tighter monetary policy. As we argued was likely to be the case, a sharp increase in food inflation in recent months sparked a sell-off in the bond market. That ultimately forced the central bank to abandon its dovish forward guidance and interest rate hikes look set to commence soon. The good news for investors is that with food inflation now around its peak and the subdued economic recovery set to cap upward pressure on core inflation, the 300-400bp of tightening that appears to be priced into the market may not fully materialise. As such, attractive entry points into the bond market may not be far away if the government can keep a lid on fiscal policy.

Chart 6: The spike in Brazilian food inflation may be around its peak



Source: Refinitiv Datastream, Schroder Economics Group. 12 February 2021.

Russia

Higher oil prices brighten the outlook

With the spike in Covid cases towards the end of last year now seemingly under control, Russia's economy should continue to recover this year supported by the rebound in oil prices. Usually conservative fiscal policy could also be eased to quell recent social unrest. We anticipate GDP growth of 3% this year and 2.3% in 2022.

Like in many parts of the emerging world, a bout of higher inflation that will squeeze real incomes will be a headwind for growth in the near term. Our leading indicators suggest that food inflation could climb towards 15% y/y in the months ahead from 7% y/y in January, which would be enough to temporarily add around 2 percentage points to the headline rate. Like in Brazil, this forced the central bank to drop its dovish forward guidance during its February rate-setting meeting, albeit greater credibility and a higher real interest rate may allow policymakers to look through higher inflation.

Scenario analysis

There are a number of risks around our baseline view. The outlook is still very dependent on the path of the virus and success of the vaccine. We are assuming a high degree of normalisation later this year allowing the service sector to return and drive the next leg of the recovery. Although we have built some scarring effects into this outlook, it is possible that new variants of the virus emerge which can dodge the vaccine and or logistical problems delay the roll out.

Our 'Vaccine fails' scenario captures these with the world economy experiencing a pick-up in cases and renewed restrictions in Q4 this year. The subsequent downturn would take the world economy back into recession and leave both activity and inflation lower than in the baseline.

China hard landing is a new scenario where the authorities tighten too aggressively

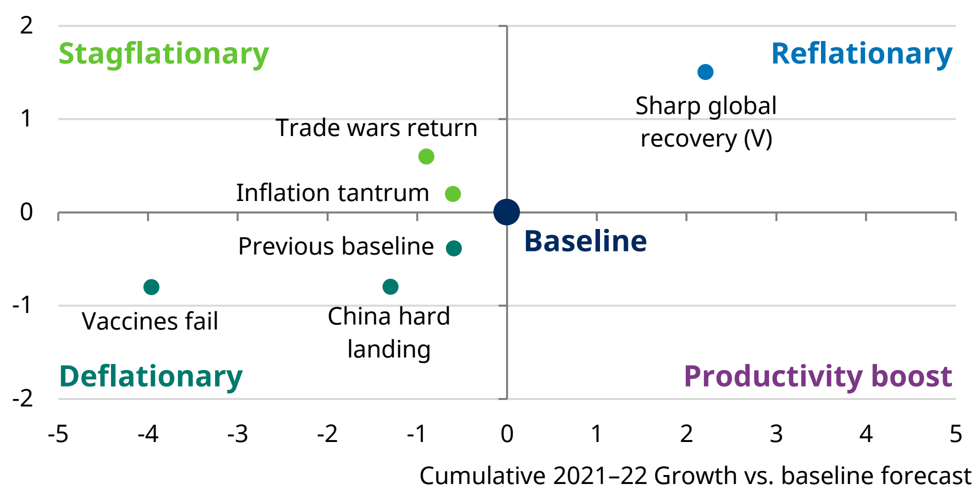
Staying with the deflationary theme we have added a new scenario 'China hard landing' where the authorities in China are too hasty in tightening policy as the economy rebounds. Activity falls sharply as monetary and fiscal support is withdrawn imparting a sharp slowdown on the economy and the rest of the world with commodity producers particularly vulnerable. The deflationary screw is given a further turn by the fall in the RMB which cuts the price of exports to the rest of the world.

We continue with the more reflationary 'Sharp global recovery' which is based on a faster and wider vaccine delivery, less scarring and greater fiscal multipliers than in the baseline. The 'Trade wars return' scenario where President Biden pulls together an international alliance to call China to account and tariffs go up in Q4 next year also retains its place. The slowdown in trade and increase in tariffs results in a stagflationary outcome for the world economy.

Finally, we have modified our taper tantrum II scenario to 'Inflation tantrum' where the rise in inflation in coming months is greater than in the baseline and proves more persistent – a development which causes the Fed to signal an earlier tightening of policy than markets are expecting. The subsequent rise in bond yields and flight to the USD hits risk assets and the emerging markets, resulting in a sharper downturn in global activity. Note that the Fed does not actually tighten policy in this scenario which is designed to acknowledge the challenge of communication when so much is priced in.

Full details of the scenarios can be found in the table at the back of the document (page 17). In terms of the impact on activity, our scenario grid shows the variation in growth and inflation compared to our baseline (chart 10).

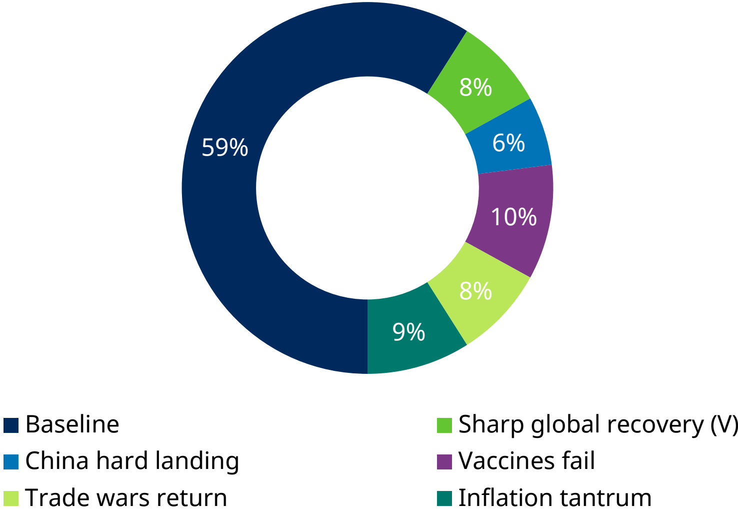
Chart 7: Scenarios growth and inflation vs. baseline forecast



Source: Schroder Economics Group, 18 February 2021. Please see forecast warning at end of document.

Although the team put the single highest probability on the 'Sharp global recovery' scenario, the balance of risks is tilted toward weaker growth with all our other scenarios bringing weaker output. On inflation though, the risks are skewed toward the upside so the net balance of risks is in a more stagflationary direction.

Chart 8: Scenario probabilities



Source: Schroder Economics Group, February 2021. Please see forecast warning at end of document.

Schroders Economics Group: Views at a glance

Macro summary – February 2021

Key points

Baseline

– **Global:** We continue to expect strong growth of 5.3% this year, helped by loose fiscal and monetary policy and a recovery in activity following the distribution of vaccines. As economies reopen, the driver of growth should change from the industrial to the service sector. Though we expect growth in the US and Europe to continue to improve in 2022, slower growth in China and wider emerging markets means that global growth should moderate to 4.6% in 2022. The rise in commodity prices push up inflation up to 2.6% 2021 from 1.8% last year, but this should moderate to 2.4% in 2022 as the commodity spike washes through and core inflation remains contained. US-China tensions should ease, although remain high as China falls short of its phase-1 commitment on purchases from the US.

– **US:** We expect growth to continue to improve through the year reaching 4.7% this year and 4.9% next year. Following the democratic sweep, we assume a $1 trillion fiscal stimulus deal, which adds 1pp to growth in 2021 and 2022. Inflation should peak at 3.4% in Q2 due to energy prices, but core inflation should remain below 2% until the second half of 2022, when we expect the output gap to close. The Fed should taper QE from q2 next year though keep interest rates at 0.25%.

– **Eurozone:** Lockdowns should mean another dip (of -1.1% q/q) for eurozone growth in Q1. Though ongoing will drag on 2021 growth, we expect a solid recovery of 3.6%. The EU recovery fund (worth 5.4% GDP) should be disbursed in H2 2021, leading to increased investment activity in 2022. Growth is forecast to pick-up to 4.8% in 2022, well above trend growth of around 1.5%. Headline inflation is due to average just 1.7% for 2020 falling to 1.2% in 2022. The ECB is likely to keep interest rates on hold, and continue its QE programme as previously announced.

– **UK:** With vaccinations advanced, activity should rise sharply at the UK eases restrictions. Fiscal policy is likely to remain very loose over the forecast horizon, backed QE until the end of this year. This should help achieve strong growth over 2021 (5.3%) and 2022 (5.1%).

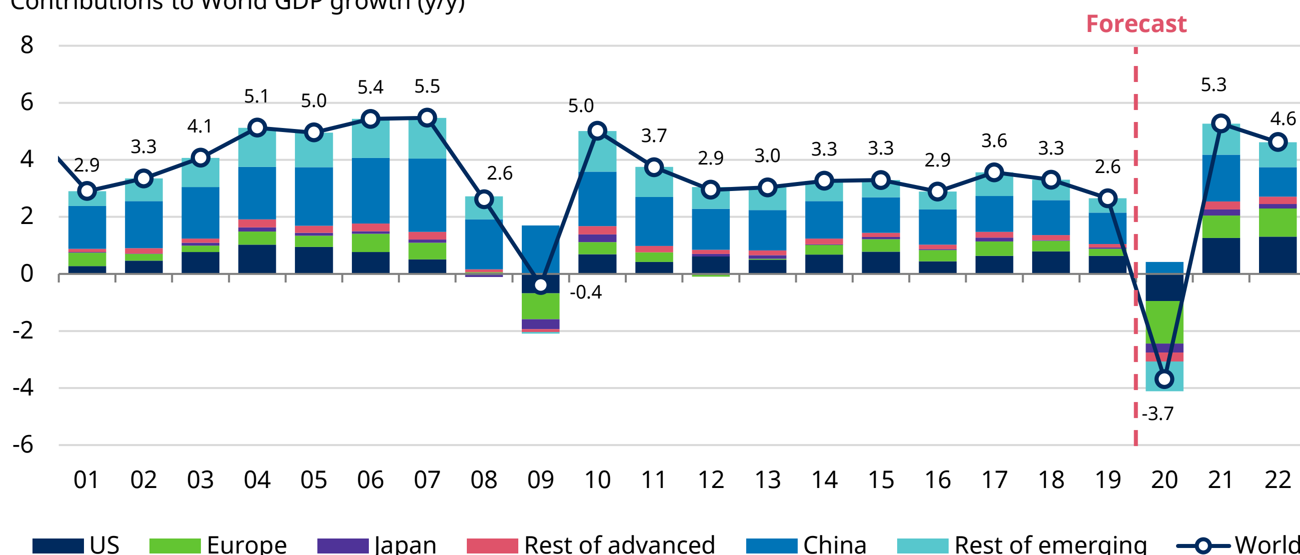
– **Japan:** The recovery in exports and the industrial sector should continue to drive the Japanese recovery, though the driver of export demand should shift from China to the US. A boost from fiscal stimulus should help growth reach 3.2% in 2021 and 2.5% in 2022. The BoJ should stay in perennial easing mode but allow more flexibility in yield curve control and Suga is likely to struggle in the LDP election.

– **EM:** We expect EM GDP growth to rebound to 7.0% in 2021, though moderate to 4.9% in 2022. With the exception of China, which is likely to experience a short bout of deflation, most EMs are likely to experience a transitory period of higher inflation led by food and energy. But once this passes and growth settles to more normal rates few central banks will be in a rush to tighten policy, particularly if governments begin to repair fiscal positions.

Risks

– Although the team put the single highest probability on the 'Sharp global recovery' scenario the balance of risks is tilted toward weaker growth with all our other scenarios bringing weaker output. The inflation risks are skewed toward the upside so the net balance of risks is in a more stagflationary direction.

Chart: World GDP forecast



Source: Schroders Economics Group, 20 February 2020. Please note the forecast warning at the back of the document.

Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2020	2021		Prev.	Consensus	2022		Prev.	Consensus
World	100	-3.7	5.3	↑	*(5.2)*	5.2	4.6	↑	*(4.1)*	4.1
Advanced*	60.9	-5.0	4.2	↑	*(4.1)*	4.2	4.4	↑	*(3.6)*	3.7
US	26.9	-3.5	4.7	↑	*(3.8)*	4.7	4.9	↑	*(3.5)*	3.6
Eurozone	16.8	-6.8	3.6	↓	*(5.0)*	4.4	4.8	↑	*(4.1)*	4.1
Germany	4.8	-5.3	2.7	↓	*(4.8)*	3.5	4.9	↑	*(4.5)*	3.8
UK	3.6	-9.9	5.3	↑	*(5.0)*	4.2	5.1	↑	*(4.5)*	5.6
Japan	6.4	-4.9	3.2	↑	*(2.9)*	2.3	2.5	↑	*(1.8)*	2.3
Total Emerging**	39.1	-1.6	7.0		*(7.0)*	6.6	4.9	↑	*(4.7)*	4.7
BRICs	26.2	-0.1	8.3	↑	*(8.2)*	7.6	5.3	↑	*(4.9)*	5.1
China	18.1	2.3	9.0		*(9.0)*	8.4	5.7	↑	*(5.5)*	5.5

Inflation CPI

y/y%	Wt (%)	2020	2021		Prev.	Consensus	2022		Prev.	Consensus
World	100	1.8	2.6	↑	*(2.2)*	2.3	2.4		*(2.4)*	2.3
Advanced*	60.9	0.7	1.9	↑	*(1.2)*	1.6	1.6	↑	*(1.5)*	1.7
US	26.9	1.2	2.6	↑	*(1.6)*	2.3	2.0	↑	*(1.9)*	2.2
Eurozone	16.8	0.3	1.7	↑	*(0.8)*	1.2	1.2	↓	*(1.4)*	1.2
Germany	4.8	0.4	2.2	↑	*(1.4)*	1.7	1.6	↓	*(1.7)*	1.6
UK	3.6	0.9	1.8	↑	*(1.7)*	1.5	1.5	↓	*(2.1)*	2.0
Japan	6.4	0.0	0.3	↑	*(-0.2)*	-0.2	0.9	↑	*(0.4)*	0.4
Total Emerging**	39.1	3.5	3.6	↓	*(3.8)*	3.4	3.7	↓	*(3.8)*	3.4
BRICs	26.2	3.2	2.9	↓	*(3.2)*	2.5	3.2	↑	*(3.1)*	2.8
China	18.1	2.5	2.0	↓	*(2.2)*	1.4	2.8		*(2.8)*	2.1

Interest rates

% (Month of Dec)	Current	2020	2021	Prev.	Market	2022	Prev.	Market
US	0.25	0.25	0.25	*(0.25)*	0.21	0.25	*(0.25)*	0.31
UK	0.10	0.10	0.10	*(0.10)*	0.02	0.10	*(0.10)*	0.19
Eurozone (Refi)	0.00	0.00	0.00	*(0.00)*	-0.56	0.00	*(0.00)*	-0.52
Eurozone (Depo)	-0.50	-0.50	-0.50	*(-0.50)*		-0.50	*(-0.50)*	
Japan	-0.10	-0.10	-0.10	*(-0.10)*	-0.06	-0.10	*(-0.10)*	-0.05
China	4.35	4.35	4.35	*(4.35)*	-	4.35	*(4.35)*	-

Other monetary policy

(Over year or by Dec)	Current	2020	2021		Prev.	Y/Y(%)	2022		Prev.	Y/Y(%)
US QE ($Tn)	4.0	7.4	8.8	↑	*(8.4)*	18.9%	9.7	↑	*(8.8)*	10.2%
EZ QE (€Tn)	2.4	2.7	3.8	↓	*(4.2)*	40.7%	4.2	↓	*(4.5)*	10.5%
UK QE (£Bn)	422	725	875	↓	*(895)*	20.7%	875	↓	*(895)*	0.0%
JP QE (¥Tn)	557	703	798	↓	*(854)*	13.6%	841	↓	*(903)*	5.4%
China RRR (%)	13.50	12.50	12.50		*12.50*	-	12.50		*12.50*	-

Key variables

FX (Month of Dec)	Current	2020	2021		Prev.	Y/Y(%)	2022		Prev.	Y/Y(%)
GBP/USD	1.37	1.32	1.44	↑	*(1.35)*	9.1	1.45	↑	*(1.28)*	0.7
EUR/USD	1.20	1.18	1.25	↑	*(1.21)*	5.9	1.27	↑	*(1.08)*	1.6
USD/JPY	105.2	105.0	107		*(107)*	1.9	107		*(107)*	0.0
EUR/GBP	0.88	0.89	0.87	↓	*(0.90)*	-2.9	0.91	↑	*(0.84)*	4.9
USD/RMB	6.46	6.60	6.50		*(6.50)*	-1.5	6.25	↓	*(7.50)*	-3.8
Commodities (over year)										
Brent Crude	60.7	43.3	58.7	↑	*(44.8)*	35.5	43.5	↑	*(36.4)*	-25.9

Source: Schroders, Thomson Datastream, Consensus Economics, February 2021
Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.
Market data as at 08/02/2021
Previous forecast refers to December 2020
* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, United Kingdom, United States.
** **Emerging markets**: Argentina, Brazil, Chile, Colombia, Mexico, Peru, China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan SAR, Thailand, South Africa, Russia, Czech Rep., Hungary, Poland, Romania, Turkey, Ukraine, Bulgaria, Croatia, Latvia, Lithuania.

Schroders Forecast Scenarios

Scenario	Summary	Macro impact	Probability*	Cumulative 2020/21 global vs. baseline: Growth	Inflation
Baseline	Global GDP growth in 2021 has been marginally upgraded to 5.3% from 5.2% and we remain above consensus. This is predominantly driven by an upgrade to our expectations for US growth as we factor in additional fiscal stimulus. Against this we make a significant downward revision to eurozone growth following longer than expected lockdowns. Our forecast for China is unchanged although other EM's are upgraded. In terms of the shape of the forecast, we continue to expect strong growth, helped by loose fiscal and monetary policy and a recovery in activity following the distribution of vaccines. Though we expect growth in the US and Europe to continue to improve in 2022, slower growth in China and wider emerging markets means that global growth should moderate to 4.6% in 2022. US-China tensions should ease somewhat in the Biden era but should remain high as China falls short of its phase 1 commitment on purchases from the US. On the inflation side, firmer oil prices push global inflation up to 2.6% in 2021 from 1.8% in 2020. Thereafter inflation should moderate as the commodity spike washes through and core inflation remains contained.	In developed markets, we expect the US and UK to achieve herd immunity first, with the eurozone and Japan lagging behind. While this results in a boost to activity in the former, the latter are still supported by fiscal stimulus and stronger global trade. In developed markets, the US is expected to surpass pre-COVID-19 GDP levels at the end of Q2 this year though the output gap should not close until Q2 next year when unemployment falls to 3.5%. Though energy prices should push headline inflation higher in 21Q2, this will be temporary. Meanwhile, we expect underlying inflationary pressures to be fairly weak allowing monetary policy to remain easy. The Fed, ECB, BoE and BoJ are expected to keep interest rates on hold through the rest of 2021 and 2022 and continue quantitative easing as previously stated. We now expect the Fed to taper QE in q2 next year. China is forecast to keep rates on hold at 4.35% and the RRR at 12.5%. We expect Brazil to raise rates this year and India and Russia to join in hiking next year.	59%	-	-
1. Sharp global recovery (V)	Global growth rebounds sharply as a vaccine is distributed faster than expected allowing activity to normalise. Fiscal and monetary policy prove more effective in boosting growth once economies open up. Business and household confidence returns rapidly with little evidence of scarring and government policies are successful in preventing output being lost permanently. This is the closest scenario to a "V shape" recovery.	Reflationary: The US surpasses its pre-COVID 19 level next quarter and closes its output gap in the second half of this year. Inflation is higher as commodity prices pick up (oil reaches $75/ barrel). In most countries, monetary policy is tightened by the end of 2021 and fiscal policy support is reined in.	8%	+2.2%	+1.5%
2. China hard landing	The strong rebound in economic activity, coupled with concerns about rising real estate and asset prices leads to an aggressive tightening of policy as the Chinese authorities continue to focus on deleveraging. The credit impulse falls sharply to a trough in mid-2021, with the usual lags to domestic demand meaning that economic growth troughs at just 1.5% y/y in Q2 2022	Deflationary: Weaker growth in China presents a demand shock for the rest of the world, primarily through demand for commodities. Inflation is also lower as a result of lower growth and lower commodity prices. Fears of a hard landing in China also spark a bout of risk aversion that is negative for Emerging Market economies and markets.	6%	-1.3%	-0.8%
3. Vaccines fail	Despite the vaccines, the population is unable to reach herd immunity and coronavirus continues to rise as a variant of the virus returns. Governments across the world are forced to lock-down again this coming winter, before re-opening in 2022	Deflationary: Growth is badly hit in this year and as lockdowns ease, the recovery in 2022 is more fragile due to the hit to confidence to both firms and businesses. Inflation is also dragged lower owing to further weakness in demand and falling commodity prices. Policy makers loosen fiscal and monetary policy further, the latter through QE. As in 2020, the authorities in China are able to effectively control the fresh outbreak of Covid and deliver a large and effective economic support package, ensuring that the economy gets back on track during the course of 2022. However, many other EMs such as Brazil and India are left with little room for manoeuvre meaning that they suffer badly and are slow to recover.	10%	-4.0%	-0.8%
4. Trade wars return	Once President-elect Biden has settled in and rekindled the United States' relationship with Europe and other allies, he leads a multilateral stance against China's anti-competitive trade policy. China's failure to reach purchasing commitments of US goods agreed in the phase 1 deal add to tensions. Tariffs on Chinese goods are hiked in Q4 2021 by the US, Europe and Japan. China retaliates in kind and tariffs then remain at these levels through 2022.	Stagflationary: Higher import and commodity prices as countries attempt to stockpile push inflation higher. Weaker trade weighs on growth. Capital expenditure is also hit by the increase in uncertainty and the need for firms to review their supply chains. Central banks focus on the weakness of activity rather than higher inflation and ease policy by more than in the baseline. In China, the renminbi is allowed to weaken in order to absorb some of the increase in tariffs, however more punitive levies and supply chain disruption cause economic growth to slow. Small, open EMs in Asia also suffer from weaker trade, but the negative impact is less on the relatively closed EMs such as Brazil and India. Some EMs may in the long-term benefit from re-orientation of supply chains. Oil producers such as Russia receive some short-term benefit from higher crude prices as energy-importing countries stock up.	8%	-0.9%	+0.6%
5. Inflation tantrum	Better than expected growth leads to higher inflation, particularly in the US. Bond investors become uneasy as they speculate on a premature withdrawal of liquidity from the Fed. As a result, US Treasury yields spike and this triggers an increase in risk aversion. Investors pull back from funding risky assets leading to a credit event.	Deflationary: Central banks do their best to step in by increasing QE but the higher risk premium persists. The tightening in financial conditions for the government and corporates hurts growth as confidence takes a hit and there is a pull back in corporate capital expenditure. An increase in bankruptcies pushes unemployment higher. A "sudden stop" and reversal of capital flows to the emerging markets causes exchange rates to depreciate sharply, forcing central banks to raise interest rates. Capital flight forces current account deficits to close in EMs such as Brazil and India, matched by declines in domestic demand that weigh on overall GDP growth. Weaker growth would also cause inflation to be lower than in our baseline scenario.	9%	-0.6%	+0.2%
6. Other			0%	-	-

*Scenario probabilities are based on mutually exclusive scenarios. Please note the forecast warning at the back of the document.

Updated forecast charts – Consensus Economics

For the EM, EM Asia and Pacific ex Japan, growth and inflation forecasts are GDP weighted and calculated using Consensus Economics forecasts of individual countries.

Chart A: GDP consensus forecasts

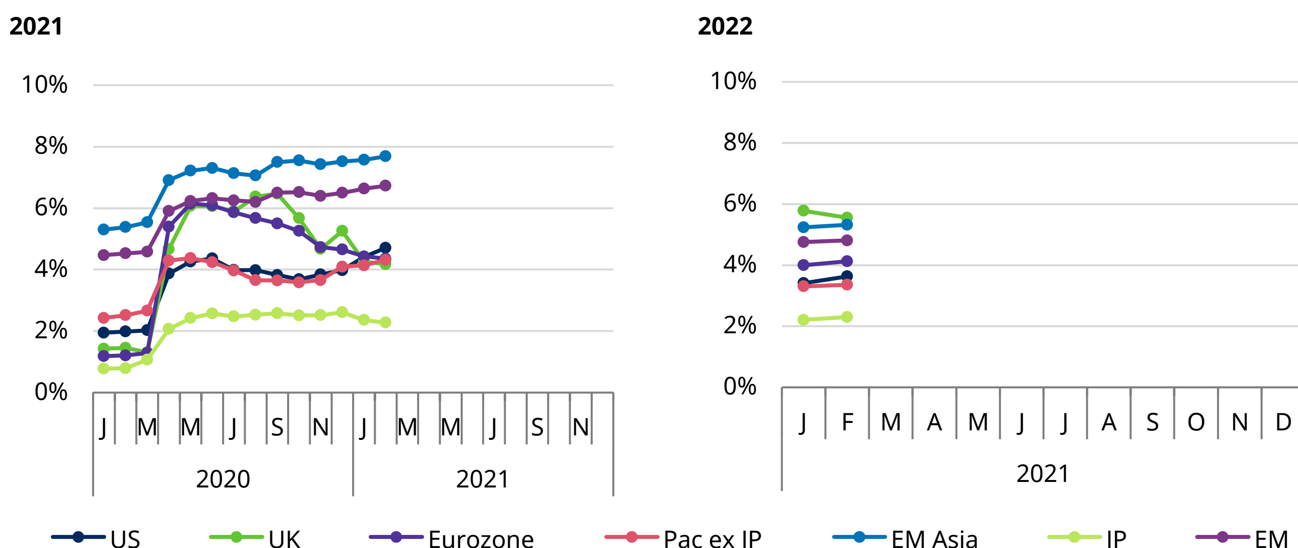
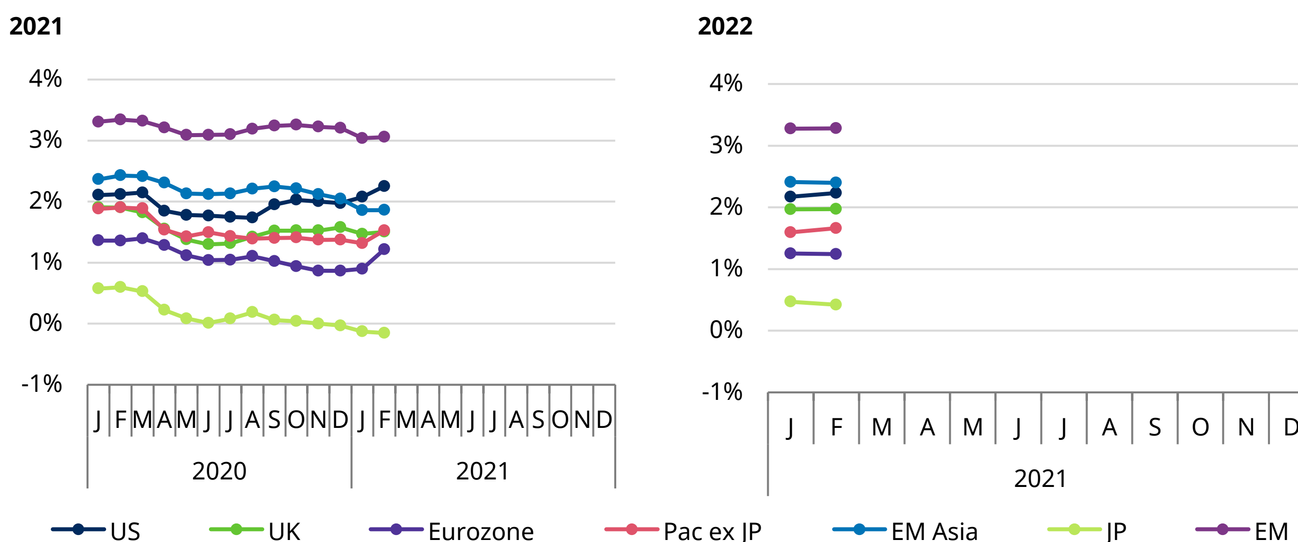


Chart B: Inflation consensus forecasts



Source: Consensus Economics (February 2021), Schroders.
Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore.
Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand.
Emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, Argentina, Brazil, Colombia, Chile, Mexico, Peru, South Africa, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Bulgaria, Croatia, Estonia, Latvia, Lithuania.

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