World in motion

The US economy's level of growth could be even higher this year than if the pandemic had never happened. But the scars are deep, as Europe's growth figures showed today. And the crisis in India continues to shock and we look at the implications in our podcast. We also examine how environmental demands are shaking up the global food industry

In this bundle

India

Listen: India's devastating second wave

India is in the grip of a particularly cruel second wave that is overwhelming hospitals and testing the endurance of a nation. In this podcast, ING's...

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Bank of England: Three things to expect from May's meeting

An improving economic outlook means the Bank of England will make some upgrades to forecasts and may also begin tapering its asset purchases at this next...

By James Smith

Article | 30 April 2021

United States | Video

Knightley: Wowzers, the US economy is hot

ING's James Knightley in New York looks at how the US economy is roaring back. Remarkably, he says the level of output at the end of 2021 could well be higher than would have been the case had there been no pandemic and the US merely continued at its trend rate of growth over the last couple of years

Wowzers! The US economy is hot

The US economy grew by 6.4% in the first quarter of this year. And stimulus measures and surging demand mean that remarkably, the level of output at the end of 2021 could well be higher than what would have been the case if the pandemic had never happened. While this is great news, ING's James Knightley cautions that Covid-19 has left a lot of scarring on the economy and supply-side capacity probably hasn't kept up with demand. And that's why inflation is likely to be higher and more sustained than we first thought. And it's also why we expect the Fed to raise rates far sooner than many people think.

Watch video

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Article | 30 April 2021 Credit | Commodities, Food & Agri | Sustainability

Where’s the beef? How flexitarians are shaking up the food industry

Increasing numbers of people are moving to a plant-based diet. And as one leading food website announces it will no longer carry recipes including beef, we think changing consumer habits will play an important role in reaching global emissions' targets

KFC teamed up with Beyond Meat to make its meat-free 'chicken' products

Where's the beef?

Some called it 'cancel culture' gone mad, others a bold welcome step. But the decision this week by the Epicurious website to drop all beef recipes is clearly a reaction to a growing trend away from meat-eating which could have major implications not just for the meat and dairy sector but also for the reduction of greenhouse gas emissions. Epicurious told its near nine million users via Twitter that the decision was not 'anti-cow' but 'pro-planet'.

And when you consider that almost 15% of greenhouse gas emissions globally come from livestock and everything involved in raising it, they may have a point. Not least because 61% of those emissions can be traced back to beef. Epicurious wants the conversation about sustainable cooking to become louder and we think it will as the move will surely inspire consumers and other companies to become more open to a diet with fewer animal-based proteins or none at all.

A demographic shift in flexitarian diet demand

And all this means that more consumers and companies are shifting away from animal-based proteins and the demand for plant-based alternatives is certainly on the rise. The global plant-based market was estimated to be valued at $10.3bn and is projected to reach $15.6bn in five years, according to this survey.

The rise of the flexitarian, where people eat mostly a vegetarian diet but occasionally meat, poultry and fish, is just what this new sector needs. These moments of 'indulgence' can be expanded with plant-based alternatives that do not compromise on taste, texture and overall experience. And it's not just about health benefits. Consumers generally understand the environmental impact of meat and dairy production.

> *Younger people in particular are more willing to switch to meat-free alternatives*

That said, switching to a vegan or vegetarian diet is still a bridge too far for many. One of the hurdles is that for those wishing to adopt a more plant-based diet means giving up some of their favourite dishes which often contain meat, just think of that juicy burger just off the barbeque.

But in the US around a third of the population is said to be adopting a vegan, vegetarian, pescatarian or flexitarian diet while in Europe that number is about a quarter. But it's growing, according to the Food Industry Association and we notice that from a demographical point of view the consumers who are more open to a diet with less meat, are younger generations like Millennials and Gen Z.

61% of greenhouse gas produced by livestock is traced back to beef

Industry disruptors challenging the traditional players

With this demand, we're seeing a range of start-ups who are now acting as industry disrupters. Good examples are Beyond Meat, Impossible Foods, The Vegetarian Butcher and Oatly. For them, it's about profit, of course, but also about sustainability.

The biggest difference with typical vegan or vegetarian brands is that these types of companies deliberately target the meat and dairy consumer, who in fact are (potential) flexitarians. Their success has not gone unnoticed amongst traditional players in the industry. The total revenue from plant-based eggs and dairy alternatives for animal proteins is expected to reach US$290bn by 2035 which represents 11% of the total animal protein market.

> *Both the disruptor and the traditional player are fighting for the*

> *attention of the same consumer*

Several traditional companies in the meat and dairy sector have taken steps to protect their shelf space and retain the 'share of wallet' of consumers. A recent example is Brazilian based JBS, one of the largest global meat producers, that acquired Dutch-based Vivera, a plant-based meat producer. The rationale behind the transaction was to further reinforce its meatless products' presence. In 2018 Unilever acquired The Vegetarian Butcher and in 2017 Danone acquired Whitewave, a plant-based dairy producer based in the US. In the end, both the disruptor and the traditional player are fighting for the attention of the same consumer and the battle eventually takes place in the supermarket on the shelves.

We've written extensively about the growth of meat and dairy alternatives. Find out more about how they're stirring up the European food industry by reading our report here.

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Germany's economy suffers a major setback

The German economy saw a severe setback in the first quarter, shrinking by 1.7% QoQ. A growth engine in the final quarter, the economy has become a drag on the entire eurozone. But not for too long

Anti-lockdown protestors in Berlin last month

Double dip it is. According to the just-released flash estimate, the German economy shrank by 1.7% quarter-on-quarter at the start of the year. In the final quarter of 2020, the economy had still defied stricter lockdowns, growing by 0.5% QoQ. On the year, Germany's economy was down by 3%. While the country was a positive growth driver for the entire eurozone economy at the end of last year, it has now turned into a drag factor.

A strong rebound is on the cards

The GDP components will only be released in the coming months but judging from available monthly data the growth drivers of the fourth quarter turned into dragging factors in the first three months of the year: industrial production and the construction sector. The reversal of a VAT reduction and stricter lockdown measures are likely to have dented private consumption.

The German economy clearly has many, very different, faces right now

In fact, the German economy clearly has many, very different, faces right now. Not all of them are properly reflected in today's numbers The major theme is one of a continuing and partly growing divergence between the service sector and the manufacturing sector. Strong demand from the US and China has filled order books in manufacturing and driven strong momentum in industrial production - even if production is still below pre-crisis levels.

Technical factors such as the reversal of stockpiling ahead of Brexit at the end of last year, the impact of the harsh winter weather on the construction sector, and supply chain disruptions have in our view significantly blurred German GDP data in the first quarter.

In any case, looking beyond possibly more short-term data distortions like the impact from the blockage of the Suez canal and ongoing supply chain disruptions, the general outlook for the German economy has clearly improved. The vaccination programme is finally getting moving and with the prospect of at least 50% of the adult population having had a first jab before the summer, a more substantial reopening of the economy should not be too far away.

Add to this potential spillovers from US fiscal stimulus, the implementation of the European Recovery Fund in the second half of the year, a (technical) rebound in the construction sector and the fact that the manufacturing sector still has not reached pre-crisis levels and a strong rebound of the German economy is in the cards. We stick to our view that the economy will reach its pre-crisis level before the end of the year.

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Article | 29 April 2021 United States

US: The bounce-back gains momentum

US GDP grew an annualised 6.4% in the first quarter with the re-opening process and ongoing stimulus set to result in double-digit growth in the second quarter. This leads us to the remarkable conclusion that the level of US GDP will be higher at the end of the year than would have been the case had the pandemic not occured

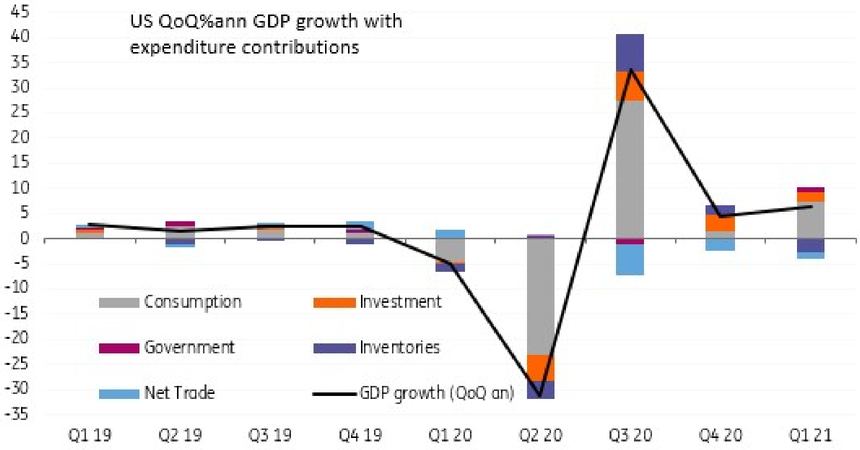
Source: Shutterstock

6.4% US 1Q21 annualised GDP growth

Growth accelerates thanks to stimulus fueled consumers

US 1Q GDP growth came in at 6.4% annualized, a little weaker than we had been looking for (7.4%) and just a touch softer than the 6.7% consensus. Consumer spending rose 10.7%, which was actually above what we had been factoring in, while non-residential fixed investment rose 9.9% and residential investment posted a 10.8% increase with government spending up 6.3%. However, a run down in inventories subtracted a hefty 2.6 percentage points from GDP growth and net exports subtracted 0.9 percentage points as strong consumer demand sucked in imports while exports fell due to economic weakness overseas.

Contributions to GDP growth



Source: Macrobond, ING

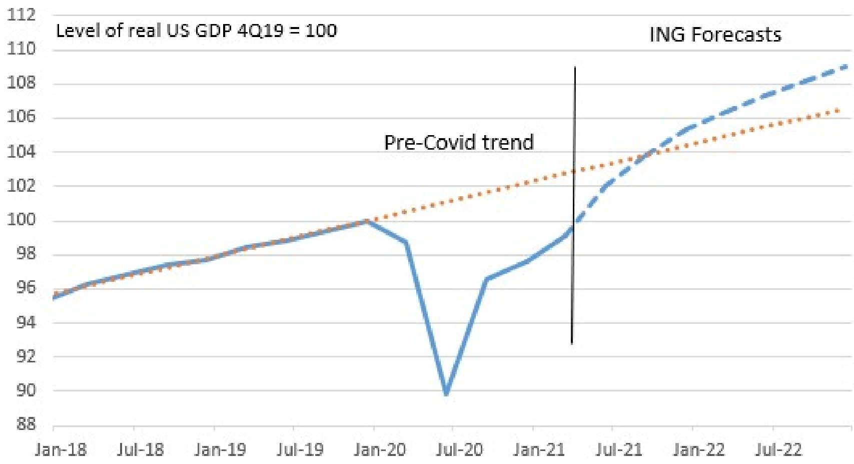
The outlook keeps getting better

Looking towards 2Q GDP, it is clear than consumer spending in March was very strong, supported by the latest $1,400 stimulus check and this provides a strong base for growth in the current quarter. Encouragingly, restaurant booking data, security check numbers at airports and daily debit and credit card transaction numbers suggest that momentum has carried through into April. With 142 million Americans also now having at least one dose of the Covid vaccine and the economy opening up more and more each day we are penciling in a double-digit GDP growth figure of around 12.5% annualized.

The US economy has already experienced $5tn of stimulus through measures enacted by Presidents Trump and Biden and is set to be boosted by an additional $4tn of spending, partially offset by some tax rises, from Joe Biden's latest infrastructure and social spending plans. That is equivalent to around 40% of GDP all in and with household balance sheets in great shape and the US economy opening up more and more we should be expecting very strong growth for several quarters to come.

GDP to move above trend

In fact we strongly suspect that the level of real GDP in the US will be higher in 4Q 2021 than it would have been of there had been no pandemic and the US economy had instead continued growing at its 2014-19 trend – see chart below.



Source: Macrobond, ING

Inflation pressures are mounting and the Fed will respond

By mid-2022 we think the level of output will be 2 percentage points above where it would have been absent the pandemic. With scarring from the pandemic hitting the US' supply capacity, this underlines our sense that inflation pressures could be more sustained than the Fed is publicly admitting. With strong growth set to boost job opportunities through the summer we expect to see a substantial shift in Fed language at the August Jackson Hole Conference that would pave the way for a December QE taper announcement. We continue to expect a rate hike in 1H23 versus the Fed's current guidance that nothing will happen before 2024.

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Podcast | 30 April 2021 India

Listen: India’s devastating second wave

India is in the grip of a particularly cruel second wave that is overwhelming hospitals and testing the endurance of a nation. In this podcast, ING's Prakash Sakpal looks at the latest developments in the pandemic and whether India's economy and markets can weather the storm

With more than 350,000 people now testing positive for Covid-19 every day in India, the country accounts for almost half of all new cases globally. As supplies run out, hospitals have been struggling to meet demand, forcing the government to call in the armed forces for help, while the US and UK have been leading a global effort to stem the crisis. In this podcast, ING's Senior Economist Prakash Sakpal tells Senior Editor Rebecca Byrne why the second wave has been so much more devastating than the first, and what it means for the economy and markets.

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Article | 30 April 2021 United Kingdom

Bank of England: Three things to expect from May's meeting

An improving economic outlook means the Bank of England will make some upgrades to forecasts and may also begin tapering its asset purchases at this next meeting. There are already hints that gilt markets are beginning to adjust to less central bank buying over coming months

Source: Shutterstock
Bank Of England, London

1 An improving outlook means upgraded forecasts

As the UK economy begins to emerge from the pandemic, we'd expect a cautiously optimistic tone from the Bank of England at its meeting on 6 May.

Indeed, the BoE's outlook has already been arguably more optimistic than most forecasters. Back in February, policymakers projected that the size of the UK economy would return to its pre-virus size around the turn of the year. While we think that may still prove to be a tad optimistic, there's little doubt the newsflow over recent weeks has helped that view.

For instance, the hit to GDP through the first quarter from lockdowns and the new EU trade deal has been much more modest than first thought. We expect the BoE to revise up its expectations for 1Q from -4.2% to roughly -1.5% (QoQ).

The BoE's outlook has already been arguably more optimistic than most forecasters

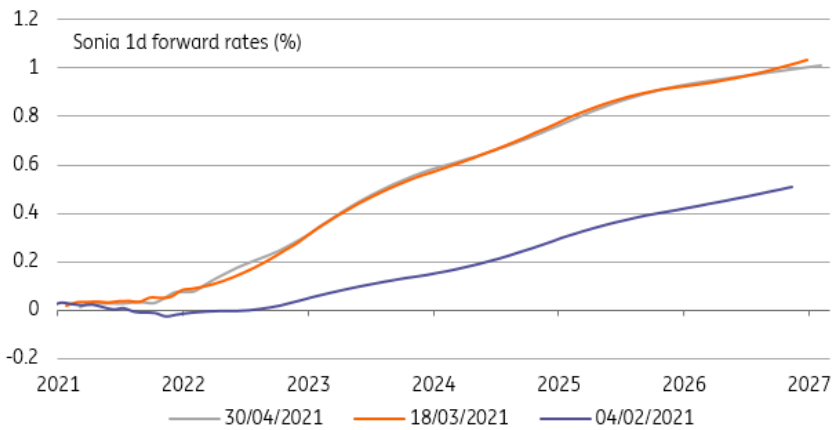
More importantly, the reopening plan potentially also means a sharper 2Q uplift than the Bank had previously been pencilling in. Meanwhile, rather quirkily, the inclusion of Covid-19 testing and vaccines into the GDP figures has artificially lifted the level of activity quite noticeably.

Another potential upgrade comes from the jobs market. The Bank previously expected the unemployment rate to peak close to 8% in the middle of the year, a big jump from the current 5% level, linked to redundancies as wage support is removed.

While it remains considerably uncertain, we suspect this is an overestimate. The fact that the Job Retention Scheme has been extended until September should enable most businesses to rebuild their finances sufficiently to be able to bring back most of their furloughed staff. We could see the peak revised down to more like 6.5%, and we think there's a fair chance the jobless rate will be falling again by year-end.

We also suspect we could see an upward tweak to the 2021 inflation profile, taking headline CPI above target. The question is whether it stays around 2% – and the Bank's forecasts from February suggested it expected the answer to be largely yes. In our view though it's more likely to drift back below target through 2022.

Sonia swaps are pricing an early but shallow tightening path



Source: Refinitiv, ING

2 Time for tapering?

That more upbeat outlook means further stimulus now looks unlikely. And in fact, we think this meeting could be the moment where the committee decides to taper the pace of its bond purchases.

Admittedly this should come as no real surprise. We know the Bank of England still has circa £110bn worth of gilt purchases to make this year when you wrap in redemptions. And at the current £4.4bn weekly pace, the BoE will hit its target level of £875bn (gilts) months before the end of the year, when it has signalled it will stop actively expanding holdings. It has already explicitly said tapering is likely.

We expect tightening to begin in 2023

What could this involve? A cut in the weekly buying pace to roughly £3bn/week from now onwards would allow the Bank to reach its target around the end of the year. The alternative option is to continue at the current, more rapid pace until the June meeting, though clearly this would require a steeper cut in pace. This would probably involve taking the weekly speed below £2.5bn/week, which would be lower than the pace generally employed in past QE episodes.

What about the longer-term tightening story? We doubt we'll get much in the way of clues this time, not least because markets have gone from pricing in zero hikes at the February meeting, to two over three years in April.

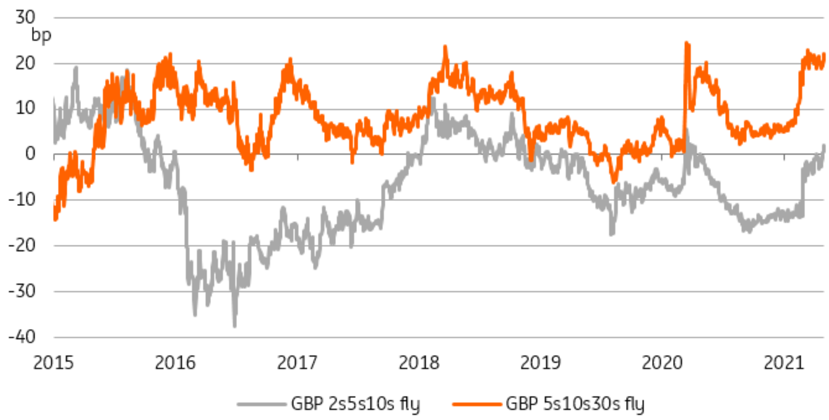
We expect tightening to begin in 2023, but there's still an open question on what mix of interest rate hikes and balance sheet reduction this will involve. It's become clear under Governor Andrew Bailey that the latter will be a part of the process. We'll have a piece out in the coming days looking at how this might work and what the impact may be. The BoE has already said it is reviewing its guidance on the future of its balance sheet, so the message is to stay tuned.

We may also hear a bit more this week on the Bank's new green mandate. As part of its new objective to support the net-zero transition, the BoE has indicated it will make changes to its corporate bond scheme when the next round of reinvestments comes due later in the year. According to our Sector Team, the most obvious way of 'greening' the scheme would be to gradually target a greater proportion of reinvestments towards high-ESG scoring issuers. Our March BoE preview looked at some of the potential challenges associated with this approach.

3 Gilts bracing for a taper

Encouraging economic developments are also visible in the performance of UK gilts. Their recent tightening relative to US Treasuries is a clear sign to us that the government bond market is bracing for lower central bank support in the coming months. The GBP rate market has also taken a resolutely European feel, refusing to retrace its 1Q sell off, and even making further headway towards normalisation. We find it entirely possible that the next leg up in traded GBP rates will be driven by a delayed 'reflation trade' in Europe, although upside risk is also building in the US.

The GBP curve is showing that BoE tightening is getting nearer



Source: Refinitiv, ING

Curve dynamics are also suggesting that the gilt market will soon have to fly on its own. The sharp cheapening of the 10Y sector of the curve, for instance in the GBP swap 5s10s30s butterfly, is indicative of a build-up in term premia. This is what one would expect to occur when normal price discovery is no longer influenced by central bank purchases.

> *There is a risk that sterling rate markets jump the gun and price in a hiking cycle too early*

Using a similar type of analysis, the fact that GBP 2s5s10s has so far failed to adjust higher is also a symptom of the uncertainty about the BoE's tightening strategy. The fact that balance sheet reduction could occur earlier in the cycle has kept the curve relatively steep. We think this is correct, but there is a risk that sterling rate markets jump the gun and price in a hiking cycle too early. If the BoE only clarifies its exit strategy later this year, cheapening pressure would build up for the 5Y sector.

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