The global economic recovery must carry the continuing weight of COVID-19

A new administration in the US, a resurgent China and a sluggish vaccine rollout in Europe make for a complicated macro environment

The world is slowly returning to normal, but will it be a new normal? It is now more than 15 months since coronavirus emerged as a serious global threat and we are still coping with restrictions on movement and huge shifts in our working and home lives. Growth has returned, buoyed by major fiscal stimulus - but according to senior economists gathered for a recent event hosted by AXA IM's Amsterdam office, the persistent waves of the pandemic will likely make that growth uneven and unpredictable.

For Gilles Moëc, Chief Economist at AXA Group, the positive story lies in a synchronised rebound of manufacturing. According to Purchasing Managers' Indices (PMIs) every major economy is now showing manufacturing activity above its long-term average – a reassuring sign for investors after a tumultuous year. There is less consistency, however, in services PMIs.

"I would say we have a clear distinction here between the US and China on the one hand, where activity is already above its long-term average, and on the other side, Europe and Japan, where you still have a way to go," said Moëc. "Obviously this difference in the services sector still has a lot to do with the pandemic, the restrictions to activity, the restrictions to social interactions."

With this in mind, one fundamental question for Moëc is whether we can look ahead to a world entirely free of the virus. In reality, he told guests, it is possible that even with a 100% vaccination rate, the prospect of new, resistant variants means eradication may be a long way off.

"Vaccine rollouts are not immune from slowdown and blips and there may still be resistant communities. We may be forced to accept some low-level restrictions for quite some time."

Flare ups

The worrying spike in cases and deaths in India has painfully illustrated the enduring risks. The country has suffered a recent sharp spike in cases with COVID-19 infections surging past 21 million, with a death toll of 230,168, the latest health ministry data showed as of 6 May.

Chang Shu, Chief Asia Economist for Bloomberg Economics, noted that vaccination rates in Asia had been lagging in general, with many countries below 20% and some still below 5% – mirroring a similar uneven record on containing the virus in the first place. In terms of the recovery, India had actually been a standout among mixed evidence in the wider region, with PMIs looking strong in March. "But clearly there is a risk here of a sharp slowdown," said Shu, "certainly in services, but likely to some extent in manufacturing too".

In the Eurozone at least, the slow start to the vaccination programme appears to have been addressed with the bloc likely now to achieve its target of 70% coverage by the end of the third quarter. That has helped underpin business confidence, but Moëc sounded a note of caution.

"There seems to be a disconnect between how great the surveys are and how actual production is behaving," he said. "This may just be that things were so bad that the surveys include some relief element that goes beyond the true rebound… Another thing to monitor is the fact that in some countries, in some industries, we are getting into bottleneck problems, we are getting into supply restrictions."

A long summer?

And for some countries in the Eurozone, particularly those heavily reliant on tourism revenue such as Greece and Spain, the prospect of another grim summer is looming. The potential extension of restrictions can be blamed on the relatively slow progress of the initial vaccine rollout, and it has a dual effect: If German workers are forced to shun Greece to spend their vacation money at home then the hit to the Greek economy is accompanied by a concurrent boost in Berlin, further sharpening the economic divide in Europe.

To address this and other issues in the European Union (EU) will require sustained and targeted fiscal stimulus, and this is coming through, said Moëc, but "that's the big difference… The US is really going hard at its fiscal push. We are much more hesitant because national authorities are a bit worried about pushing the public debt a bit too far."

This more measured pace of stimulus means that EU countries will only see the peak of the Next Generation EU recovery plan in 2023-2024, he added. That partly helps to explain why the debate over inflation risks is less marked in Europe than in the US.

Price pressure

The sheer scale of the US stimulus has encouraged those worries over prices as the recovery appears to take hold alongside accommodative monetary policy and a sharply increased savings rate built up while people adhered to pandemic restrictions.

According to Richard Vietor, Professor of Business Administration at Harvard Business School, the debate is now raging among US economists, and among the voices of concern has been Larry Summers, a former Chief Economist at the World Bank who served in the administrations of two US Presidents, Bill Clinton and Barack Obama.

"So this was a surprise in the United States, because Larry Summers is a liberal economist and normally he would support what [US President Joe] Biden is doing, but he really shocked the country by taking issue with it and citing the risks of inflation," Vietor said.

Summers' fear is either that inflation leads to stagflation, where slow growth and high unemployment accompany higher prices, or that the Federal Reserve (Fed) overreacts to send the US into recession. The other side of the debate sees the Fed getting it right, keeping a lid on inflation while higher growth is sustained.

China roars back

Away from the immediate debate around inflation, the US is changing course for the medium term under its new President, Vietor noted, even if longer-term issues around the current account deficit and debt-to-GDP ratios will eventually have to be dealt with too. The "America First" mantra has died with former President Donald Trump to make way for a resumption of globalisation. Biden's decision to rejoin the Paris Agreement on climate change reflects that new dynamic, and there will be revitalised relationships with partners in Europe and possibly in Latin America too. Global poverty will be a renewed focus, as will an inevitable peak in fossil fuels and the rise of electric vehicles.

Crucially too, the world will be watching for a new chapter in relations with China. For Vietor, Biden has set out his stall: "[China] has to have fair trade with the United States and they cannot take our technology and they can't subsidise their state-owned enterprises… [But} are the tariffs are going to go away tomorrow? No, they're not.

“Eventually, I suspect the United States and China will enter negotiations over subsidies and technology and try to pin that down. The tariffs are just hurting consumers in both countries.”

For Bloomberg’s Chang Shu, the trade tensions between the two countries remain a problem – the rhetoric may have cooled, but the policies remain in place. “I see this as a very big risk factor and a downside risk factor for China and the region,” she said.

It might be that the pandemic has put China in a stronger position. Growth in 2020 may have been the slowest in four decades, but at least it was growth, noted Shu. For 2021, Bloomberg has raised its growth forecast for China to 9.1% from 8.2% forecast in December.

China has already managed to resume pre-pandemic growth rates, even if it is yet to regain the growth path it would have been on without the virus interruption. That recovery, as in Europe, has been driven by manufacturing while services have understandably lagged. But there is a bigger story here as China pursues its wider goal of reorienting the economy away from manufacturing, and so it is no surprise to see services picking up again from March as containment measures are relaxed and private consumption resumes. Retail sales in particular have shown strength, said Shu, while Beijing has signalled a more gradual removal of fiscal support than many had expected.

AXA’s Moëc pointed out that the ripples from China’s recovery have reached European shores. “If you look at the traction from the Chinese market onto German exports, it's actually been quite brilliant over the last few months,” he said. In short, China has underpinned the rally in global demand.

And Europe may even come out of the pandemic a little stronger too. Combined with the effect of Brexit, there is a feeling that the bloc is showing more unity, demonstrated by the acceptance of debt mutualisation as a principle in the recovery plan. And on Brexit: “What the British side tried to do was create division within the EU and they failed miserably, I would say, until in the end the EU negotiated as a pack, which means that we can deal with what was a really complicated structural issue in a fairly good way politically,” Moëc said.