Independent Wealth Partners
March 2021 economic outlook

Key points

- Economic growth levels across most developed countries are increasing, supported by major fiscal stimulus programs and the ongoing rollout of COVID-19 vaccinations.
- On a monetary policy level, central banks are leaving official interest rates unchanged and in some cases increasing purchases of government bonds to counter higher longterm yields.
- Headline inflation levels are expected to rise gradually in key markets, but longer-term structural trends will likely limit the extent of consumer price rises.
- Employment trends remain mixed, in line with the pace of recovery in specific countries as they deal with the impacts of the pandemic.

Economic growth

With the passage of the US$1.9 trillion American Rescue Plan Act of 2021 on March 11, IWP foresees the United States economy growing in a range of 7% to 7.5% for all of 2021, an increase of 2 to 2.5 percentage points compared to what our projection would have been without the new stimulus.

We expect first-quarter growth to be modestly above 5% as most Americans receive stimulus payments, and that the current pace of COVID-19 vaccination will support a significant pickup in economic activity in the second half of the year.

A slower pace of COVID-19 vaccinations puts the euro area behind both the United Kingdom and the U.S. on that front and increases the risks related to its timetable for easing COVID-19 restrictions. We foresee euro area GDP growth around 5% for 2021, with GDP reaching its pre-pandemic level in the next 12 months or so.

GDP in the United Kingdom is estimated to have fallen by –2.9% in January, attributable to restrictions related to COVID-19. The services sector, which contracted by –3.5%, bore the brunt of the effect. But better days appear to be ahead as case numbers fall, the pace of vaccination increases, and restrictions are expected to be lifted by the end of the second quarter. Although we expect a first-quarter contraction in activity, we foresee a meaningful economic rebound in the second and third quarters and full-year 2021 growth around 6%.

In China, robust industrial production and exports offset moderate weakness in consumption in January and February. The resilience in the economy is bringing consensus estimates for China's full-year 2021 growth closer to IWP's forecast around 9%. At the annual National People's

Conference in early March, Chinese officials set a 6% growth target for the year and a goal of doubling the size of the economy by 2035, which implies average annual growth around 4.7%.

GDP rose more than expected in the fourth quarter in Australia, by 3.1% compared with the third quarter on a seasonally adjusted basis, topping consensus estimates of 2.5%. The more solid base makes IWP more optimistic about prospects for Australia's growth in 2021; we now foresee growth for the full year around 5%, and the economy reaching its full potential by the second half of 2022. Full-year 2020 growth came in at negative 2.4%.

Vaccine breakthroughs and rollouts in developed economies make IWP optimistic that emerging markets on aggregate will grow by more than the 6% outlook we communicated at the end of 2020. We continue to see emerging Asia lead the way, with 2021 growth above 8%. The region's pandemic management continues to bear fruit and export-driven models are benefiting as global recovery takes hold.

Monetary policy

The U.S. Federal Open Market Committee voted on March 17 to leave the target range for its federal funds rate unchanged at 0%–0.25% and its bond-buying program unchanged. IWP foresees a potential third-quarter 2023 lift-off for the Fed's rate target. We believe the Fed would need to see substantial progress toward achieving its dual mandate of stable prices and maximum employment, which Fed governors saw as being some time off, before slowing its US$120 billion per month in purchases of U.S. treasuries and agency mortgage-backed securities.

The European Central Bank (ECB) left its key rates intact at its March 11 policy meeting but signalled a "significantly higher pace" of asset purchases under its Pandemic Emergency Purchase Programme (PEPP). The unspecified increase in bond-buying is intended to counter rising borrowing costs within a European Union still struggling with the health and economic effects of COVID-19. IWP expects that the ECB will increase its purchases from around €12 billion per week to around €20 billion per week to counter higher yields on longer-dated bonds.

The Bank of England (BOE) maintained its bank rate at 0.1% at its March 17 Monetary Policy Committee meeting and left its UK government bond purchase program target unchanged at £875 billion. The BOE noted that global GDP growth had been stronger than anticipated since its last meeting. We expect the bank's asset purchases to continue through the end of 2021, with an increase in the bank rate likely only a year later.

The Reserve Bank of Australia (RBA) left its cash rate and three-year government bond target intact at 0.10% at its March 2 policy meeting. The RBA reiterated it was unlikely to raise the cash rate until 2024, the earliest it foresees actual inflation sustainably within its 2% to 3% target. For that to occur, the RBA said, significant gains in employment and a return to a tight labour market would be required to push wages higher.

Policymakers in China are likely to recalibrate policy in their effort to stem gains in debt-to-GDP levels and to ward off financial bubbles. IWP expects China to gradually withdraw both monetary and fiscal support to achieve these aims. On the fiscal side, the government will aim to reduce its official fiscal deficit target from 3.6% to 3.2% in 2021. On the monetary side, policymakers will aim to slow credit growth, though in our view the People's Bank of China will refrain from outright policy rate hikes this year.

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We expect expects central banks in emerging markets to continue to maintain an easy monetary policy, but rising yields in the United States could constrain that effort to a degree.

Inflation

The Consumer Price Index (CPI) in the U.S. rose 0.4% in February on a seasonally adjusted basis compared with January, with petrol prices accounting for more than half the rise. Core CPI, which removes volatile food and energy prices, rose just 0.1%. Compared with a year earlier, the broad price index rose 1.7%, while core prices were up by 1.3%. IWP expects core U.S. inflation to surpass 2% in the coming months as base effects—comparisons to low year-earlier numbers—magnify price rises as people re-engage in face-to-face activities. But we expect the rise above 2% to be short-lived, and that long-term structural trends that have kept inflation low for more than a decade will continue to limit price rises.

Headline inflation rose by 0.9% in the euro area in February on an annual basis, unchanged from January, according to the final estimate from Eurostat, the European Union's statistical agency. Underlying price pressures remain subdued amid weak labour bargaining power and low inflation expectations. We expect core inflation to gradually rise toward 1.5% as the pace of economic recovery increases in the second half of the year, with occasional upside volatility owing to supply-chain bottlenecks related to Brexit and a global semiconductor shortage.

We expect both headline and core inflation in the UK to rise toward the Bank of England's 2% target over the next year as the effects of lower energy prices unwind and the economy strengthens. Headline inflation rose by 0.7% in January compared with a year earlier, up from a 0.6% rise in December.

Despite some modest base effects, or comparisons to low year-earlier prices, IWP doesn't expect core inflation in Australia to approach the RBA's 2% to 3% target range anytime soon. We expect that spare capacity in the broad economy and in the labour market will leave core inflation around 1.5% by year's end, higher than the RBA's forecast of 1.25%.

We expect core consumer prices in China to strengthen in the second quarter as activity normalises further. We expect higher commodities prices to feed into producer prices, but pass-through effects to consumers may be capped. Consumer prices rose by 0.6% in February compared with January but were down – 0.2% compared with February 2020. The Producer Price Index rose 1.7% in February compared with a year earlier, and 0.8% compared with January.

Emerging markets continue to diverge, with disinflation (inflation well below target), a concern in parts of Southeast Asia, notably Indonesia and the Philippines.

Employment

The unemployment rate in the U.S. fell slightly in February, to 6.2% compared with 6.3% in January, while the U.S. labour market added 379,000 jobs. IWP foresees the headline unemployment rate falling toward 5% by year's end, and into the low 4% range, closer to pre-pandemic levels, by the end of 2022.

Unemployment in the euro area was 8.1% in January 2021 on a seasonally adjusted basis, unchanged from a revised 8.1% in December 2020, and up from 7.4% in January 2020. The unemployment rate in the UK rose to 5.1% in the three months ended in December 2020, up slightly from 5.0% a month earlier and a sixth straight month of increase.

The unemployment rate in Australia fell to 5.8% in February from a revised 6.3% in January. Despite relatively upbeat recent labour market reports, IWP doesn't expect Australia will reach full employment, which the RBA has suggested it would consider to be around 4.5%, before 2022.

Asset class returns

Our 10-year annualised nominal return projections are as follows.

Asset Class	Median Volatility	10 year annualised return outlook
Australian equities	21.0%	4.7%-6.7%
Global ex-Australia equities (unhedged)	19.4%	4.3% – 6.3%
Australian aggregate bonds	4.6%	0.6% – 1.6%
Global bonds ex-Australia (hedged)	3.1%	0.9% - 1.9%

IMPORTANT: The projections or other information generated regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes are derived from 10,000 simulations for each modelled asset class.