

# A new normal that looks uncomfortably familiar

Advanced Economies  
Outlook Q4 2021

Joeri de Wilde

Triodos  Investment Management





The first signs of a slowdown in the remarkable pace of the global economic recovery have emerged. Still, a slow but steady normalisation in advanced economies implies a continuation of above-trend economic activity expansion. Vaccination progress and steadily fading supply constraints will allow for the further release of both household and corporate pent-up demand, which is still considerable due to elevated savings rates and depleted inventories.

The consumption-driven recovery has allowed global trade to stage a vigorous recovery, surpassing its pre-pandemic level and reaching new record highs. This has certainly prevented more severe economic scarring, but by returning to the old hyper-globalised status quo resilience and sustainability have again been left out of the equation. Policy makers should therefore take back control of trade, instead of leaving it to multinationals to decide the rules of the game. Reaching the world's 2030 Sustainable Development Goals (SDGs) requires finding the right balance between localisation and more extensive global cooperation.

# Advanced Economies Outlook Q4 2021

## A new normal that looks uncomfortably familiar

Joeri de Wilde

The near-term prospects for the global economy are still rosy, despite the recent loss of global economic growth momentum. The largest part of the warp-speed recovery lies behind us, but for the remainder of the year we still expect above-trend global growth. Major advanced economies that haven't reached pre-pandemic GDP levels yet will do so this year (Japan) or in the course of 2022 (eurozone, UK).

In our base scenario, which assumes a near to complete removal of COVID-19 restrictions in advanced economies in the final quarter of 2021, we expect global annual economic growth rates of 5.9% in 2021 and 4.5% in 2022. In our alternative scenario, where household savings rates stay elevated for longer than we expect due to prolonged virus-related uncertainty, and where persistently high inflation dents real disposable income, we expect global annual economic growth rates of 5.4% in 2021 and 3.8% 2022.

Based on our fundamental approach, we maintain our cautious asset allocation stance and remain underweight in equities and neutral in bonds. We do not think that the current elevated valuations properly reflect underlying fundamentals and assume central banks can't keep financial assets inflated forever. We

prefer high-quality names, as margin pressures are building, and negative earnings surprises are lurking. The possibility of a sudden sharp rise in interest rates resulting from rising inflation expectations also makes us cautious.

### Pausing for breath

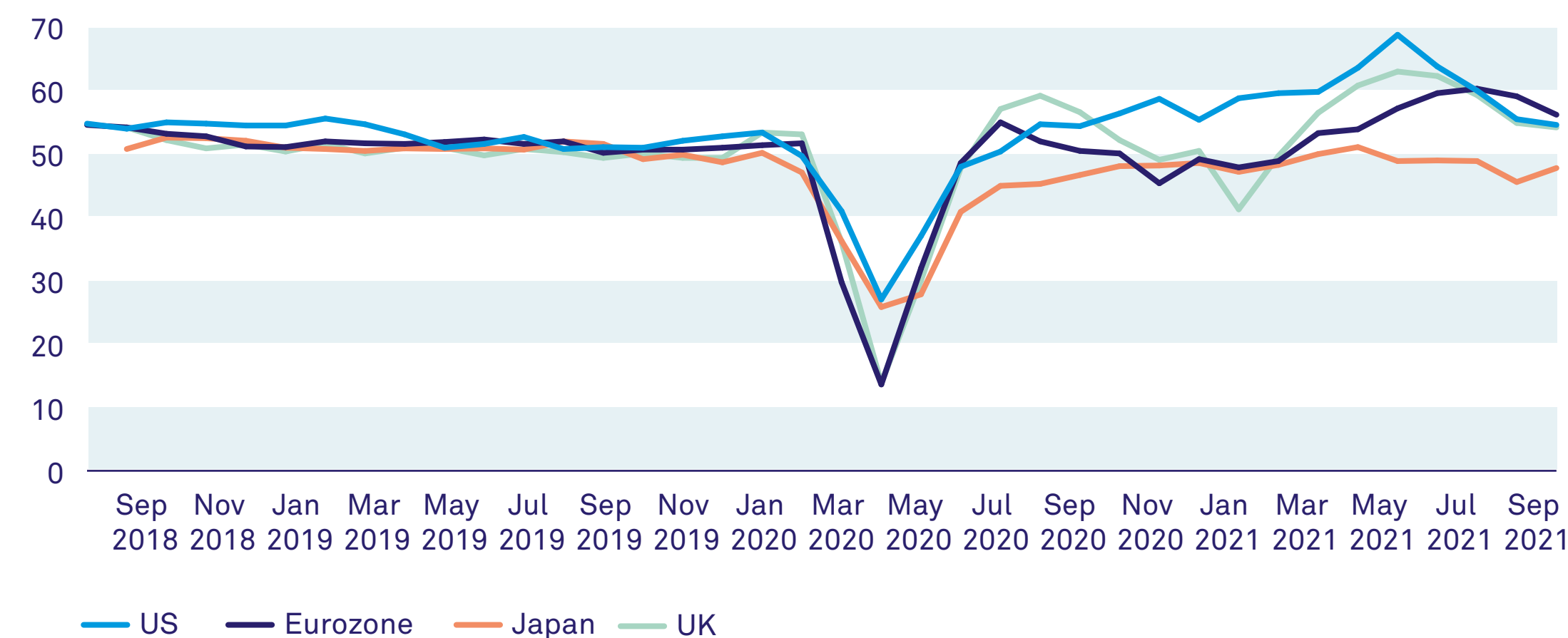
During summer, several economic indicators signalled a slowdown in the pace of the global economic recovery. This was mostly driven by stalling recoveries of the world's two largest economies: the US and China. Other major advanced economies that experienced a softening in their expansion of economic activity were the UK and Japan (see figure 1). There were several related reasons for this slowdown: economies normalising after the record-speed recovery, the spread of the COVID-19 Delta variant, supply constraints and a slight deterioration of consumer confidence.

In case of the US and the UK, the slowing recovery pace could be partially explained by the fact that these countries were the first major advanced economies to ease restrictions (on the back of rapid vaccination

campaigns). This meant sharp upticks in household spending and a quick ramp-up in capacity utilisation levels, which reduced output gaps. Now that these economies have regained a substantial part of their production capacity, a slowdown in the rate of expansion is inevitable. This also holds true for the eurozone, which experienced the reopening boom a few

months later due to continued restrictions, but where capacity utilisation is also steadily approaching pre-pandemic levels and where business surveys recently also signalled that economic activity is coming down from its peak acceleration rate.

Figure 1 Business activity as proxied by composite PMIs (50 = no change)



Source: Refinitiv Eikon, Markit, Triodos Investment Management; Data for September is based upon flash PMIs.

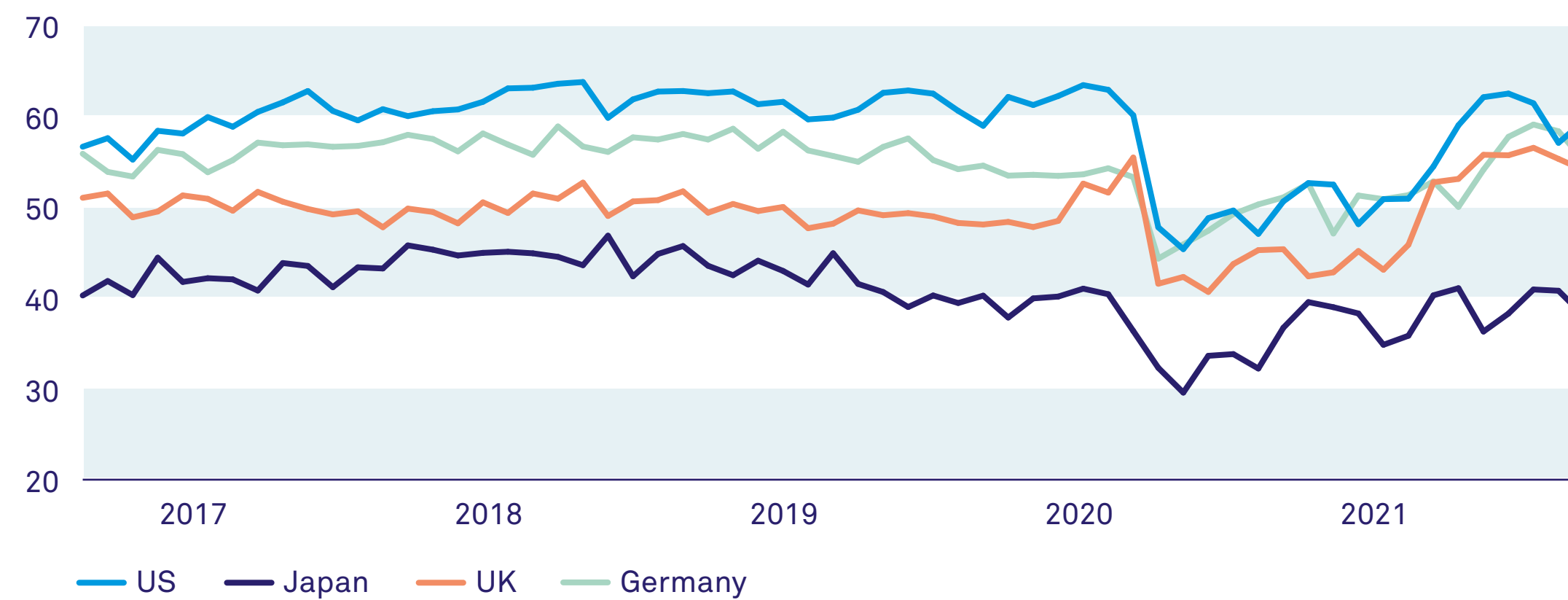
## Advanced Economies Outlook Q4 2021

The spread of the more infectious COVID-19 Delta variant has also negatively influenced the recovery of advanced economies, especially Japan. Due to a belated start, Japan is still trailing the other major advanced economies in vaccination rates, and therefore had to reinforce its *state of emergency measures* in large parts of the country during summer. More in general, advanced economies felt the effects of the global spread of the Delta variant through

continued supply constraints that limited companies in meeting the surging global demand. Factory and port closures in Asia led to global material shortages and transportation delays, and, especially in the US and the UK, activity slowed down because of shortages and mismatches in labour. This inability of supply to meet demand has led to a surge in inflation within most advanced economies.

The ongoing burden of COVID-19, for instance through strong price rises, has partially reversed the previous rise in consumer confidence. Moreover, the trouble caused by new virus mutations like the Delta variant has set the notion that a rapid return to the 'old normal' has become far less likely. The idea of a 'new normal' of living with the virus has, for now, made consumers more uncertain about the future (see figure 2).

**Figure 2 Consumer sentiment** (Index, Thomson Reuters / Ipsos)



Source: Refinitiv Eikon, Triodos Investment Management..

### Pent-up household and corporate demand implies further strong expansion

Our expectation for global economic growth to remain above its long-term trend well into next year is based upon the assumption that there is still plenty of pent-up demand from households and companies in the pipeline. This will lead to strong household spending, inventory building and capital expenditure.

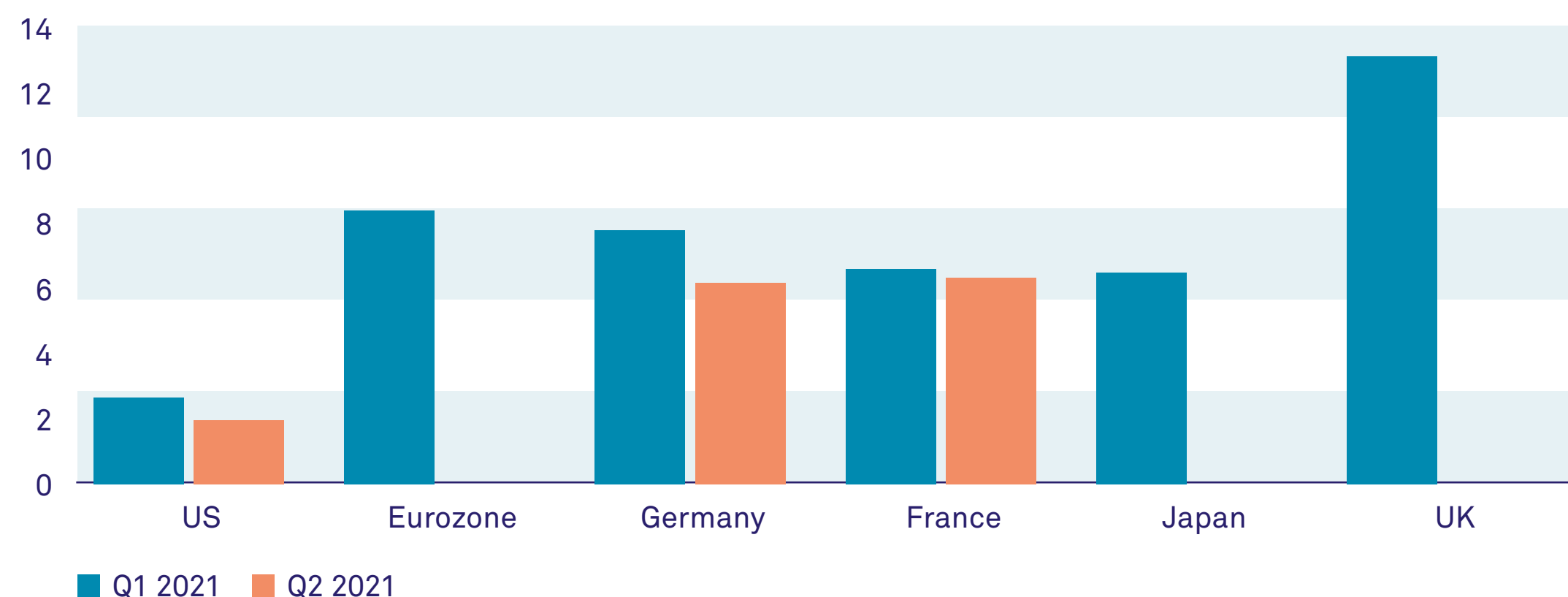
Household savings rates are still elevated in most advanced economies, with the US being the notable exception (see figure 3). Therefore, households in most countries have some way to go before their savings rates have returned to pre-pandemic levels. Next to that, a huge amount of excess savings has been built up during the pandemic, equalling 6% to 6.5% of annual GDP in the eurozone and Japan, close to 8% in the UK, and 11% in the US (Société Générale estimates). This

implies that part of the pent-up demand is still in the pipeline, waiting for savings to be spent once supply constraints ease and services become completely available again once restrictions have been lifted. We don't expect that the majority of the excess savings will be spent, due to some persistency in COVID-related uncertainty and a generally low(er) propensity to spend out of income amongst higher-income households, which have accumulated most of the excess savings.

However, merely normalising the savings rates will already provide a further economic growth boost. Evidence so far also suggests that the increase in services consumption does not come completely at the expense of consumption of goods, boding well for further household spending growth.

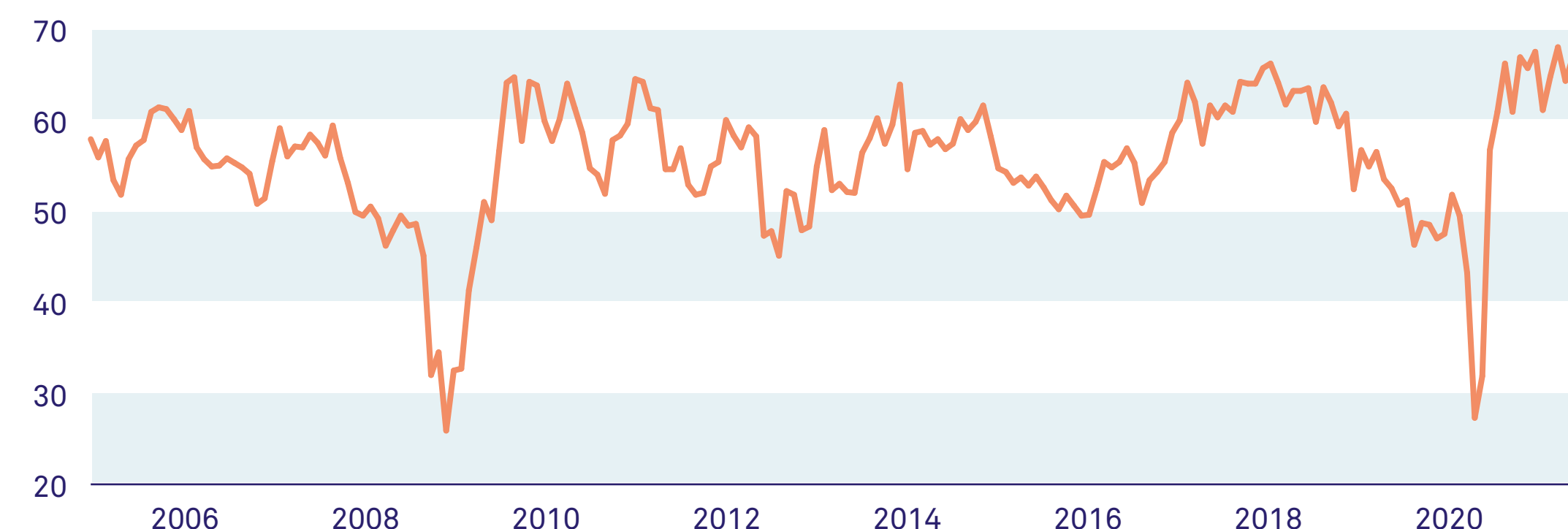
Corporate surveys confirm that there is still plenty of pent-up demand in the pipeline. As figure 4 shows, new

**Figure 3 Household savings rates** (difference with pre-pandemic levels (2019) in % of disposable income)



Source: Refinitiv Eikon, Société Générale, Triodos Investment Management.

**Figure 4 US ISM manufacturing new orders** (Index, 50 = 'no change')



Source: Refinitiv Eikon, Triodos Investment Management.

## Advanced Economies Outlook Q4 2021

orders in advanced economies (as proxied by the US) are still increasing at a near-record pace. Therefore, manufacturing output should rise once supply constraints fade, to meet the current demand and still expanding orders backlog. On top of that, companies need to rebuild inventories, and if they aim to improve resilience, this inventory-push might be even more considerable than currently expected.

Similarly, corporate demand for capital goods in advanced economies is still growing. New orders for capital goods in the US have sharply increased ever since May 2020 to more than 18% above pre-pandemic levels. Although growth in business equipment spending has moderated recently, we expect it to remain strong on the back of surging consumer demand and depleted corporate inventories, which will both increase the need to raise production and hence demand for capital goods.

Surely, there are some preconditions that must be met to allow the strong household and corporate demand to underpin the increase in economic activity. First, supply constraints should continue to steadily ease, and restrictions should be further lifted across advanced economies. We think these are realistic expectations,

as the world will steadily improve its vaccination rate, meaning that the need for factory or port closures and other restrictions will diminish. For the same reason, we expect both consumer and corporate confidence to halt their recent downward move, as this was mostly induced by Delta concerns. As time goes by, consumers and companies will get more used to the idea of a 'new' normal where COVID-19 becomes an endemic disease, making new mutations less likely to further deteriorate sentiment (provided that vaccines remain effective).

As supply constraints slowly ease, we assume that price surges will do the same, although we expect some pressures to be more persistent. Our overall assumption is that we have seen the peak of price pressures in the US though and will also leave behind peak eurozone inflation in the coming months. This will reduce the drag of inflation on household purchasing power. The current labour shortages are at the same time expected to support moderate wage growth, which should be beneficial for households' real disposable income (under the assumption that the possible wage growth inflation push will be limited and incomparable to recent levels of inflation).

Household spending could be negatively impacted by the ending of the fiscal support that has boosted household income since the beginning of the pandemic. In the US, the UK and the eurozone, emergency support measures will have mostly been lifted as we enter the final quarter of this year. Nevertheless, we expect this impact to be rather limited, as people have built up plenty of buffers, and the labour market is tight.



### Global trade back to unsustainable hyper-globalised status quo

Over the years, the steady increase in global trade has undoubtedly brought prosperity, for instance through the reduction in consumer prices and the creation of jobs in emerging economies (see our emerging economies outlook). More recently, the vigorous recovery in world merchandise trade, which in November 2020 already surpassed its pre-pandemic level and was close to 6% above this level in June (see figure 5), has also been key to avert more severe global economic scarring that could have emerged from the COVID-induced recession.

At the same time, the COVID-induced supply chain constraints have painfully demonstrated how fragile our global trade system has become. The move to just-in-time delivery and the complicated, highly specialised global supply chains have come at the expense of economic resilience and national sovereignty. The pandemic has also demonstrated that in our *hyper-globalised* world, multinationals have largely taken over control. Therefore, business activity focused on maximising shareholder value at all costs has been the dominant force shaping the global trade system, which has come at the expense of other stakeholders.

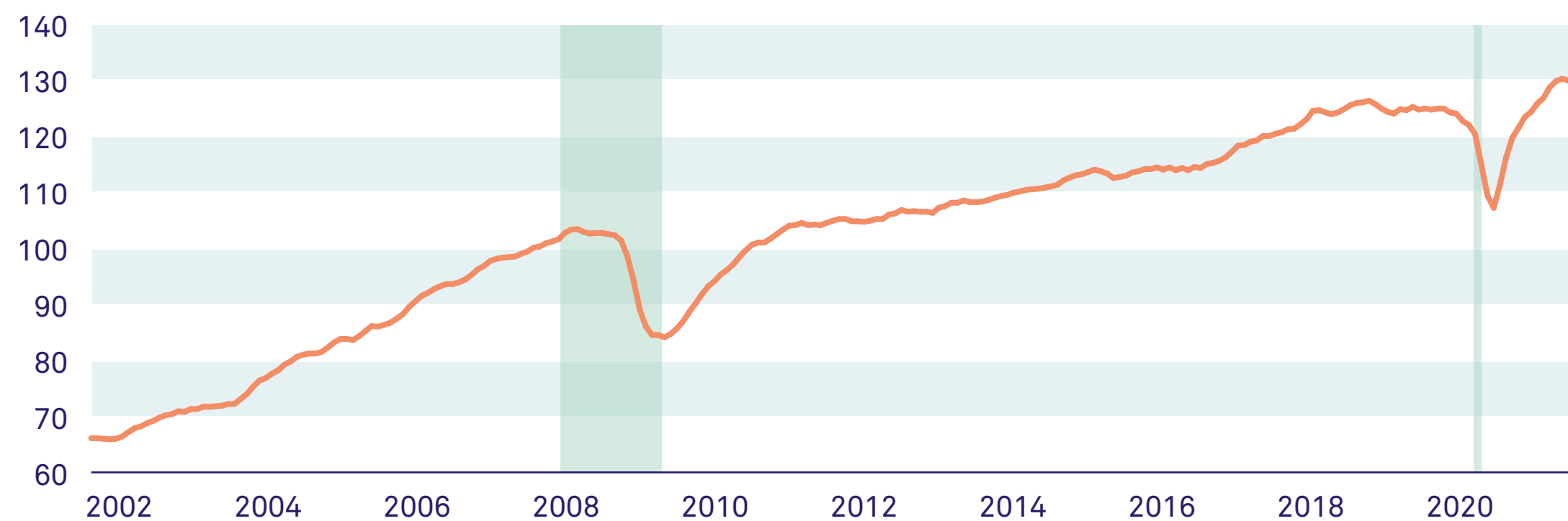
While these issues were already addressed before the pandemic, a renewed sense of urgency to step away from the narrow-minded focus on efficiency and (over) consumption was obviously felt last year, leading to calls for more resilient and sustainable supply chains: making supply chains less vulnerable and polluting, by building buffers, making supply chains less fragmented, and reducing the enormous movement of goods around the world was put high on the agenda of governments, businesses and civil society organisations.

However, with global merchandise trade currently being at near-record highs, only coming down slightly

in July after peaking in June (see figure 5), up till now no real change can be observed on a global scale. The deliberate choice made by many advanced economy governments to stimulate a consumption-driven recovery, with generous fiscal packages fuelling short-term goods consumption instead of targeting long-term prosperity, has facilitated the return to the old hyper-globalised status quo.

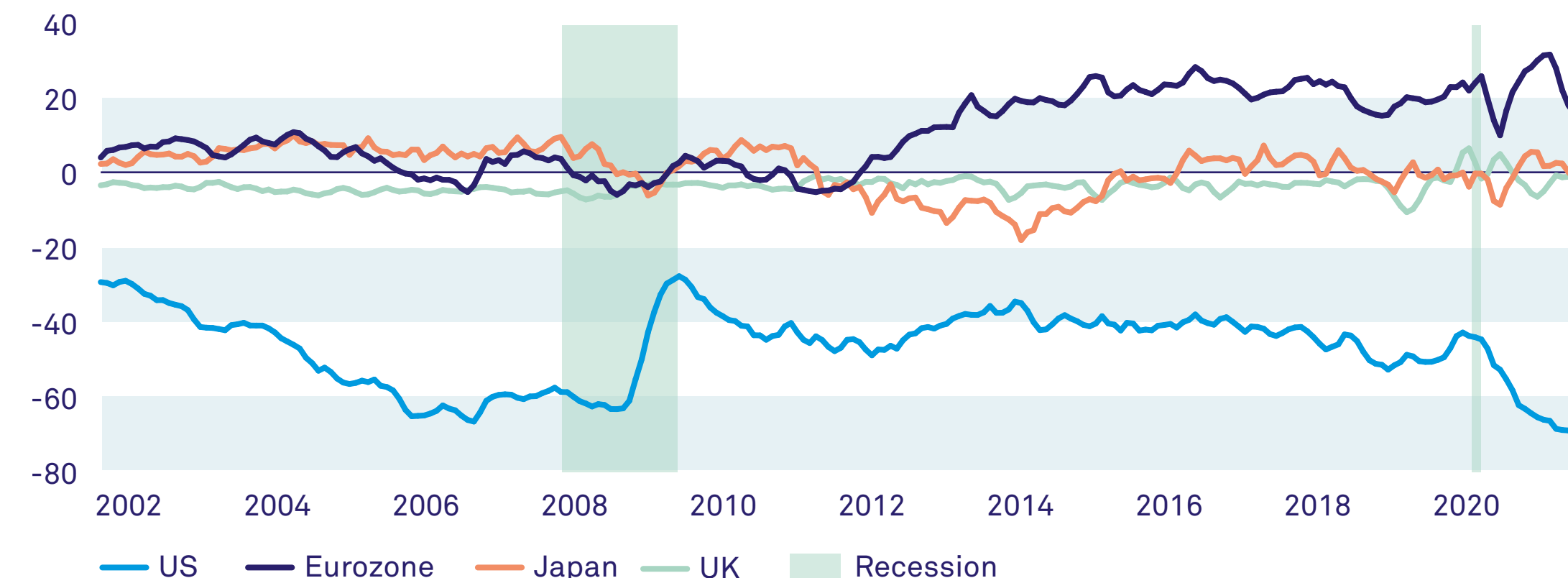
Though not much seems to have changed on a global level, trade balances (exports minus imports) of the major advanced economies have been affected in different ways by the pandemic (see figure 6). For the US, the effect has been negative, with a severely

Figure 5 World merchandise trade volume (Index, 2010 = 100, three-month moving average)



Source: Refinitiv Eikon, Triodos Investment Management.

Figure 6 Trade balance in goods and services (USD billions, three-month moving area)



Source: Refinitiv Eikon, Triodos Investment Management.

widened deficit. This was mainly due to an 8% surge in imports up till June, led by increases in household goods, computers, and semiconductors. Exports fell by 5% up till June, due to sharp drops in civilian aircrafts and engines, petroleum products and automotive-related exports (see figure 7).

Consequently, net trade will turn out to be the most important drag to the otherwise strong US economic

growth in 2021. It is interesting to observe that, besides household goods, US imports of semiconductors and pharmaceutical products have also increased compared to pre-pandemic levels. This indicates that the calls for the reshoring of vital production so far have not (yet) been translated into more protectionist trading patterns.

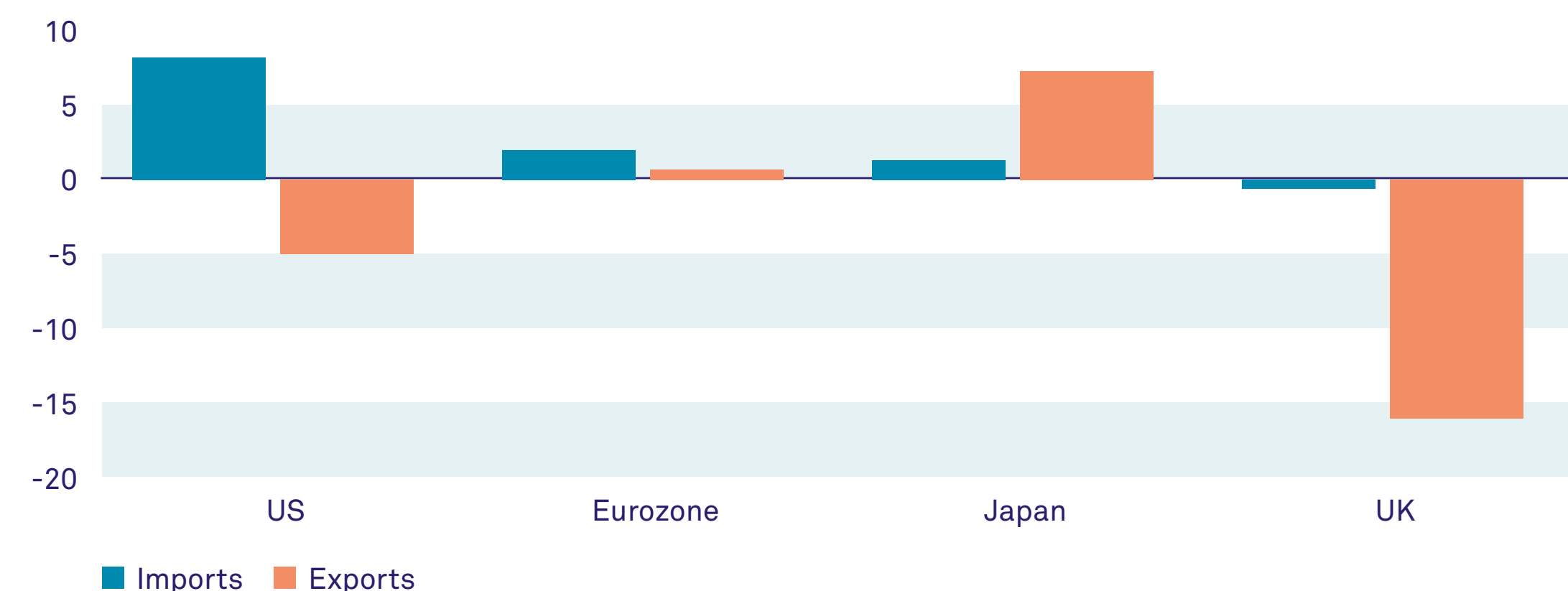
The UK's trade balance has also been negatively impacted ever since the pandemic struck, as it at the same time had to cope with the effects of Brexit. Combined, this means that net trade will detract from this year's economic growth. Exports have plunged over 16% up till June compared to pre-pandemic levels, and as opposed to developments in the US, imports have also slightly dropped (figure 7).

Contrastingly, after last year's initial fall in trade surplus, eurozone exports picked up again, thereby facilitating a push from net trade for eurozone economic growth in 2021. The trade surplus is currently a bit below pre-pandemic levels, as imports have continued their increase while exports have come slightly down. In similar fashion, Japan has this year benefitted from the surge in goods demand from Western economies, allowing for a positive push from net trade for economic growth. Exports have risen by over 7% compared to pre-pandemic levels up till June, while imports rose by a smaller proportion. So far, it seems that besides the US, trade balances of the major advanced economies haven't been structurally changed by the pandemic.

Of course, geopolitics always plays an important role in global trade developments. Therefore, the protectionist move amongst global powers in the last few years was closely followed. This development was of course dominated by the US-China trade war that was started by former US president Trump to become less dependent on Chinese manufacturing and halt China's rise to power. Starting mid-2018, tariffs were imposed on one another's goods, which did indeed seem to have some effect on the US trade deficit with China. Since November 2020, however, this trend has reversed again. As US president Biden has also expressed his desire to become less dependent on China, this could theoretically lead to a structural change that encompasses more domestic production and supply chains being relocated to allied countries. Regionalisation could in that case come to replace the current hyper-globalised trading system. However, so far, there is no macroeconomic evidence that this is happening, and we don't see this affecting global trade materially in the short term.

Overall, the post-pandemic trade system still looks uncomfortably similar to the pre-pandemic situation. Of course, it is difficult to change complicated global supply chains in relatively short time, and there has

Figure 7 Goods trading volumes (difference most recent with pre-pandemic levels, %)



Source: Refinitiv Eikon, Triodos Investment Management.



been some recent anecdotal evidence of companies (planning to) changing their sourcing, but on a macro level we so far see no indication of a move towards a more resilient and sustainable direction. This is worrying, as the recently published **IPCC report** points at the urgent need for a complete overhaul of our economic system to tackle the climate crisis. Therefore, we urge governments and companies to search for an integrated approach that both tackles the downfall of hyper-globalisation through more localisation, and at the same time embraces the benefits of more extensive international cooperation.

Companies can do so by shifting their focus from short-term efficiency to longer-term resilience, so that they act in the best interest of all relevant stakeholders, not just their shareholders. On a national level, governments can start taking back control of global trade by implementing laws that hold companies accountable for human rights violations and environmental destruction in their entire supply chains, such as the recently finalised German **“Act on Corporate Due Diligence in Supply Chains”**. Internationally, governments should closely work together in order to force companies to pay their fair share of taxes in the countries where they operate,

building on the **global minimum tax agreements** made by the OECD and G20 earlier this year. Extensive international cooperation is also needed to form proper global legislation and governance that will lead to sharp reductions in greenhouse gas emissions. In this respect, next month’s United Nations climate conference COP26 will be crucial.

### Cautious allocation stance

Despite the slowdown of the global recovery, equity markets continued to reach new record highs during the third quarter. This was the result of rising markets in July and August. In September, however, most markets halted their seemingly never-ending rise. Looming tightening of the major central banks was an important reason for the move downwards, next to the potential default of China’s second largest real estate developer, Evergrande.

We now expect that the Federal Reserve (Fed) will announce the tapering of its USD 120 billion monthly bond purchases as early as November. Fed projections also indicate that a potential interest rate hike in 2022

### Growth projections

GDP growth (%)	2020	Baseline		Alternative	
		2021	2022	2021	2022
Global	-3.3	5.9	4.5	5.4	3.8
US	-3.5	6.0	3.9	5.6	3.4
Eurozone	-6.6	5.0	4.6	4.0	2.9
UK	-9.9	6.9	5.4	6.5	4.0
Japan	-4.8	2.7	2.8	1.9	2.4
China	2.3	8.4	5.7	8.0	5.0

has become more likely. As for Europe, we expect a taper announcement by the Bank of England before the year has ended. The ECB has recently also decided to slow its monthly EUR 80 billion purchases related to the Pandemic Emergency Purchase Programme, though ECB president Lagarde stressed that this isn’t the same as tapering. Concerning Japan, recent data on the Bank of Japan’s bond purchases indicated that the slowdown in purchases has continued. Despite these rather hawkish developments, we still expect the major central bank’s tightening processes to be

very gradual and continue to assume that the central banks will be able to keep inflation expectations firmly anchored.

Eurozone government bond yields have reversed their downward trend lately, but yields continue to be close to historic lows, making eurozone government bonds very expensive. The ECB seems committed to prevent any significant rise in the borrowing costs for governments, meaning the low yield environment will likely continue for quite some time. With respect to

## Advanced Economies Outlook Q4 2021

eurozone corporate bonds, spreads are still narrow, as strong corporate earnings positively affect risk sentiment and investors continue their search for yield now that eurozone government bond yields are still low. We expect the demand for corporates to stay strong, but nevertheless remain cautious and prefer high quality names. Financial difficulties may still arise further down the road when stimulus measures are being lifted. The threat of rising interest rates due to a sustained pickup in inflation and the Fed starting with tightening also makes us confident in our cautious approach. Overall, we remain neutral in bonds.

We apply the same caution to equities. Broader market valuations are still unattractive. The US equity market continues to look expensive, both historically and relative to Japan and Europe. We believe margin pressures are building, and as we gradually enter the next stage of the recovery, we are leaving behind the period of sharply upward earnings revisions. Looking ahead, we believe negative earnings surprises are lurking, in which case lower equity prices and valuations would be entirely warranted. Rising inflation expectations resulting in sudden rises in bond yields continue to pose an additional risk to equity markets.

Overall, we do not think that the current valuations properly reflect underlying fundamentals and assume central banks can't keep financial assets inflated forever. We therefore remain underweight in equities.



# Disclaimer

- > This document has been carefully prepared and is presented by Triodos Investment Management.
- > It does not carry any right of publication or disclosure, in whole or in part, to any other party.
- > This document is for discussion purposes only.
- > The information and opinions in this document constitute the judgment of Triodos Investment Management at the time specified and may be subject to change without notice, they are not to be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient. Under no circumstances is it to be used or considered as an offer to sell, or solicitation of any offer to buy, nor shall it form the basis of or be relied upon in connection with any contract or commitment whatsoever or be taken as investment advice.
- > The content of this document is based upon sources of information believed to be reliable, but no warranty or declaration, either explicit or implicit, is given as to their accuracy or completeness.
- > This document is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.
- > All copyrights patents and other property in the information contained in this document is held by Triodos Investment Management and shall continue to belong to Triodos Investment Management. No rights whatsoever are licensed or assigned or shall otherwise pass.
- > All copyrights patents and other property in the information contained in this document is held by Triodos Investment Management and shall continue to belong to Triodos Investment Management. No rights whatsoever are licensed or assigned or shall otherwise pass.

## About Triodos Investment Management

With over 25 years of experience as a globally active impact investor, and as a wholly owned subsidiary of Triodos Bank, Triodos Investment Management has developed deep sector-specific insights across Energy & Climate, Inclusive Finance, Sustainable Food & Agriculture, and Impact Equities and Bonds. Offering impact solutions through private equity, debt, and listed equities and bonds, our assets under management amounted to EUR 6.1 billion as per 30 June 2021.

## Investing in positive change

For more information about our impact investment strategies, please contact our Investor Relations team at:  
+31 (0)30 694 2400  
TriodosIM@triodos.com  
[www.triodos-im.com/impact-equities-and-bonds](http://www.triodos-im.com/impact-equities-and-bonds)

## Published

September 2021

## Text

Joeri de Wilde,  
Triodos Investment Management

## Design and layout

Via Bertha, Utrecht

## Cover photo

Absolutvision