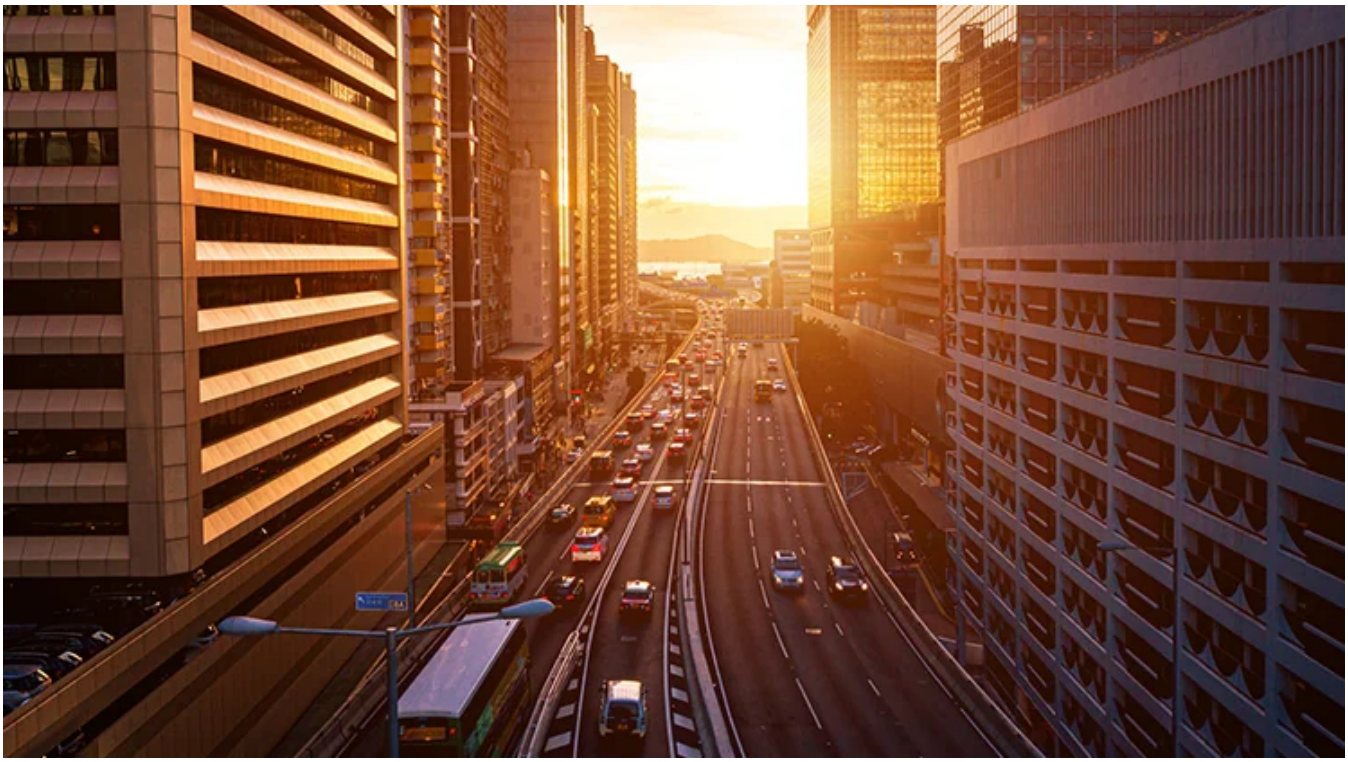
Perpetual

Three headwinds to global growth

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As expected, the global economy is rebounding very strongly in 2021, led by the US in the first half and likely to be followed by Europe and emerging market economies in the second half as lockdowns and other social mobility restrictions ease. Here we discuss our market outlook.

Global growth was very strong in the first half and is expected to accelerate in the second half of 2021 as the vaccination roll-out continues apace, releasing pent up demand by reopening economies in the developed world. Growth is expected to slow in 2022 as fiscal policy becomes a drag and pent up demand is satisfied. As a result, profit estimates for this year and next continue to be revised up, so much so that 2022 earnings per share in the US are expected to be almost a third higher than in 2019.

There are, however, some more problematic developments for the market outlook:

- Inflation in the US has been much higher than expected in recent months. These misses have been attributed to 'transitory factors' caused by supply side bottlenecks, most notably in used cars (as a spill-over from excess demand for new cars) as well as sporting goods, furniture and appliances. A lot hinges on this assessment as monetary policy settings are so extreme – our own view is that core inflation will subside from recent levels back towards 2% next year as some of these 'one-offs' reverse. With growth estimates expected to be well above potential growth, however, average core inflation will likely be somewhat higher than we previously estimated.
- The emergence of the highly contagious Delta variant has wreaked havoc in India, become the dominant strain in the UK and Australia, and is growing rapidly elsewhere. The growth in cases in the UK has happened despite a population with a high level of natural immunity and vaccinations. On the more encouraging side, there are some indications that the vaccine is working to significantly reduce the risk of severe disease.
- The outlook for Australia is especially delicately poised given the combination of a highly contagious variant and low levels of vaccination and natural immunity. The economy has recovered very well, but the second half of 2021 is going to be difficult to navigate if the virus becomes established in the most populous states.

Financial markets are continuing to run hard with the upbeat growth and profits story, while largely ignoring the risks created by recent higher inflation prints and the emergence of the Delta variant. In fact, there are very few signs of distress in financial markets as equity, credit and commodity markets all continue an amazing run of performance, which began in the depths of despair at the onset of the COVID-19 crisis in March last year. However, we will be keeping a close eye on some of the dark clouds we see on the horizon.

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