Key Developments[1] & Chart of the week

23 April 2021

The US, Canadian, and UK economies are strengthening; the EU remains in the doldrums

	Outcome	Previous	Comment
Bank of Canada	Surprise announcement of immediate tapering of QE		
US composite PMI (April)	62.2	59.7	An all-time-high reading
EU composite PMI (April)	53.7	53.2	Europe still largely in the doldrums
UK retail sales (March, m-o-m)	5.4%	2.2%	UK shoppers celebrate

Canada monetary policy

- The Bank of Canada surprised, announcing an immediate 'tapering' of its bond-buying program (from C$4bn to C$3bn a week) and foreshadowing a possible first increase in interest rates "*some time in the second half of 2022*".[2] Canada's economy is being boosted by the US.

US PMIs

- The US PMIs were unexpectedly strong, reaching all-time highs: Manufacturing 60.6; Services 63.1; Composite 62.2. And all this notwithstanding unprecedented supply chain disruptions.
- The pace of recoveries, country by country, is being driven by two factors – fiscal expansion and vaccinations: and the US has both in spades.

EU PMIs

- Purchasing managers are showing little net optimism. While manufacturers' expectations are buoyant (63.3), services remain lacklustre (50.3). The EU fiscal boost is not being anticipated.

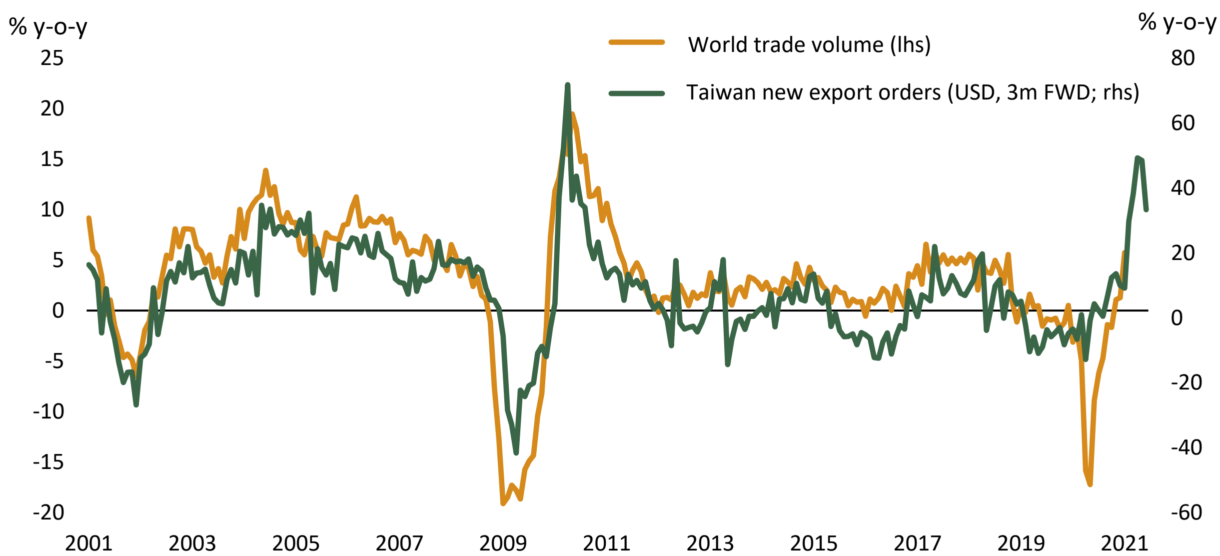
UK retail sales

- Non-food sales, including importantly clothing, drove this strong pick-up, aided by strong demand from automotive fuel retailers as travel restrictions were eased.
- In turn, service activity generally was strong: the April flash PMI Services Activity Index, at 60.1, up from 56.3 in March, expanded by its greatest extent since August 2014.[3]

***Bottom line**: No material challenge so far to our World View[4] for output,[5] nor for inflation[6] – unless or until wages start to accelerate. That is what we watch for most closely.*

Chart of the week. Taiwan export orders point to strong world trade growth ahead

- Q1 export orders are up on average by 44% on the year, compared with 25% for Q4 last year.[7]



Source: Macrobond and Llewellyn Consulting

[1] *Key Developments* presents what in our judgement represent the past week's most important individual data and other developments. These are selected, in an attempt to counteract the risk of Kahneman 'confirmation bias', as those best able to reveal the extent to which the key assumptions and relationships that underpin our *World View* remain valid – or not, as the case may be. Generally we feature hard data rather than forecasts or survey results; but make exceptions in important cases.

This approach is particularly important at present because the COVID-19 shock that has hit economies and markets is both large and novel, twin conditions that typically challenge understanding, and lead to unusually large forecasting errors.

[2] Canada's economy stands to receive a substantial 'knock-on' boost to aggregate demand from the two US fiscal packages. The Bank of Canada (BoC) is just the second amongst the advanced economies (it follows the Norges Bank last week) to foreshadow an earlier than expected tightening of monetary policy. It announced an immediate 'tapering' of its bond-buying program (from C$4bn to C$3bn a week), and foreshadowed a possible first increase in interest rates "*some time in the second half of 2022*", by which time it now expects "*economic slack*" to have been absorbed, and its 2% inflation target "*sustainably achieved*". The BoC also foreshadowed having "*more to say*" about "*signs of extrapolative expectations and speculative behaviour in the housing market*" next month.

[3] Meanwhile, the monthly CPI index rose by 0.3%, driven primarily by motor fuels and clothing. Factory gate (i.e., PPI output) inflation rose sharply to 1.9% y-o-y in March, from 0.9% a month earlier, due importantly to compositional effects. Slack in the economy and labour markets seems likely however to prevent one-off price spikes turning into a more 'sustained' rise in inflation.

[4] Our recent *World View*, published in February, presents full underlying argument and supporting evidence.

[5] In our *World View* we expect GDP growth to continue strongly in China; and the Biden fiscal stimulus augurs strongly for the US. Furthermore, the recent Biden infrastructure package stands to underpin recovery, both on the demand and on the supply side. Elsewhere among OECD economies a proper recovery seems likely only once the vaccines restore a 'new normality'. Historically, re-attaining pre-recession GDP levels has taken some years, and post-recession growth is slower than its prior trend.

[6] While the aggregate price level in different economies may spike from time to time, capacity and labour markets are generally not strained, and it seems at present unlikely that such shocks as may hit the aggregate price level will turn into a price/wage spiral. Markets are fretting about future US inflation in the context of the big Biden fiscal package; but with inflation constrained almost everywhere else, international price competition stands to keep a lid on inflation globally – and perhaps even curb any incipient price pressure in the US, where a significant part of the expenditure increase may spill over into the current account of the balance of payments rather than into domestically-generated inflation. For more, see our *Rising US inflation concerns,* 12 February.

[7] As a note of caution, the monthly numbers are volatile (not seasonally adjusted) due to the timing of Lunar New Year, but the upward trend is clear nevertheless.