Key Developments[1] & Chart of the week

7 May 2021

Strong US output growth continues; and international divergences in trade balances widen

	Outcome	Previous	Comment
US PMIs: Manu/svces (Apr)	60.7/62.7	64.7/63.7	Strong though lower than expected
US trade balance (Mar)	-$74.4 bn	-$70.5 bn	Third consecutive record deficit
China trade balance (Apr)	+$42.9 bn	+$13.8 bn	Probably peaking (at around 4% of GDP)
Central banks	Brazil hikes, Norway foreshadows hikes, UK stands pat		
US non-farm payrolls (Apr)	266 K	770 K	This volatile series does it again

US PMIs. Still strong despite falling short of (exuberant) market expectations

- Both manufacturing and services ISM indexes declined in April and fell short of market expectations – but were nonetheless both unambiguously strong.[2]
- More notable were the further increases in the 'prices paid' components, up 4 ppts to 89.6 for manufacturing, and up 2.8 ppts to 76.8 for services.[3]

International trade. Current account and trade and imbalances continue to widen

- The US recorded a deficit of $74.4 bn on trade in goods and services in March, a third consecutive monthly record.[4] China's trade surplus meanwhile increased.[5]

Central banks. Brazil hikes, Norway again foreshadows hikes, UK does not move

- Brazil raised its key policy rate by 75 bp to 3½%.[6] The Norges Bank re-affirmed that it may move later this year.[7] The BoE did not move, but upgraded its growth forecast.[8]

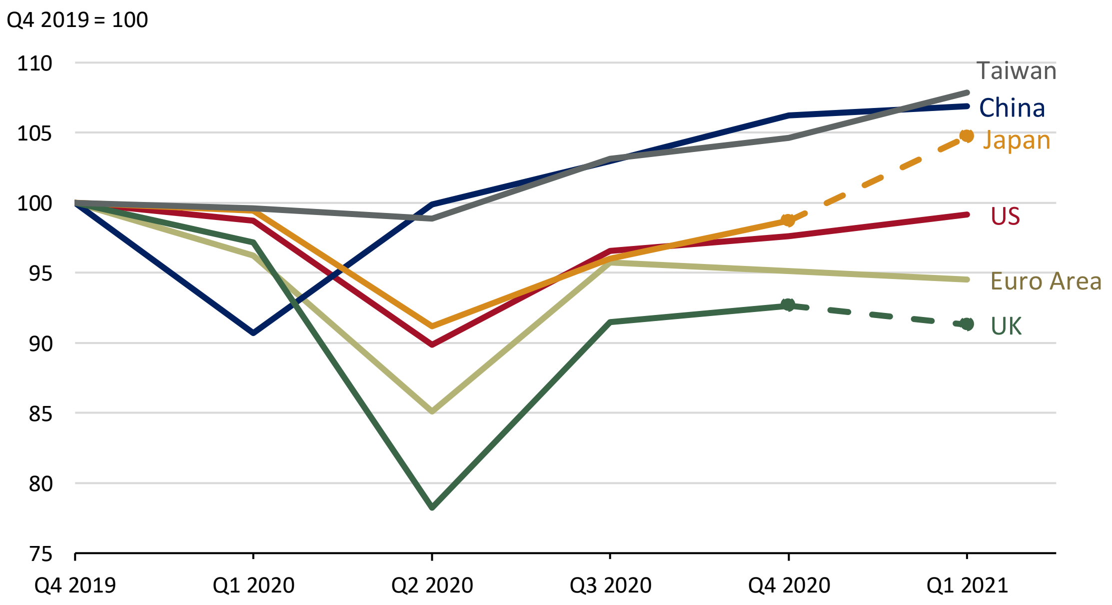
US non-farm payrolls. A surpassingly low figure

- While the 266 K figure[9] was way lower than the expected 1 million-odd it is likely, given the strength of the US recovery, that next week's figure will look quite different.

***Bottom line**: No material challenge so far to our World View[10] for output,[11] nor for inflation[12] – unless or until wages start to accelerate, which we watch for most closely.*

Chart of the week. Asian countries' GDP has done best so far: Europe and the UK the worst.

- While much commentary focuses on (extraordinary) growth rates, it is primarily levels that matter.



Source:[13]

[1] *Key Developments* presents what in our judgement represent the past week's most important individual data, policy announcements, and any other developments that may support, or challenge, our understanding of the way in which key economies and financial markets are evolving.

These weekly judgements are cumulated and assessed in our quarterly ***Economic and Financial Risks***. When an issue warrants particular consideration, we examine it in detail in our analytic *Comment* pieces and *Global Letters*. And when in our judgement the accumulated evidence warrants it, we modify our quarterly ***World View.***

[2] The manufacturing figure exceeded 60% for the third time in five months, and services for the second time (a level exceeded only 15 and 8 times, respectively, since 2000).

[3] In both cases the highest since July 2008.

[4] The goods deficit widened to a record $91.6 bn, while the services surplus narrowed to $17.1 bn, the smallest since January 2012.

[5] China's trade surplus widened to US$43 bn in April, after narrowing in February and again in March. Exports in the 3 months to April were 35% higher than in the corresponding period of 2019, compared with a 28% increase in imports over the same interval. But the momentum behind growth in imports appears to be stronger, suggesting that China's trade surplus may be 'topping out' (for now) at around 4% of GDP.

[6] The Bank of Brazil's increase was its second in a row. Cited reasons were concerns over inflation, fiscal policy risks, and faltering structural reforms.

[7] Specifically, The Norges Bank said that "*the policy rate will most likely be raised in the latter half of 2021*".

[8] The Bank of England (BoE) surprised somewhat with a stronger assessment of the economy: the GDP growth forecast for this year was upgraded to 7.25%, a significant increase from its prior projection of 5%. That said, the BoE is not concerned about the inflation outlook, citing the spare capacity in the economy and transient nature of the upward inflationary forces: "*In the central projection, CPI inflation rises temporarily above the 2% target towards the end of 2021, owing mainly to developments in energy prices. These transitory developments should have few direct implications for inflation over the medium term, however*."

Hence "*The Committee does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably*."

[9] Job gains in leisure and hospitality, other services, and local government education were partly offset by losses in temporary help services and in couriers and messengers. The unemployment rate was little changed at 6.1%.

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

[11] In our *World View* we expect GDP growth to continue strongly in China; and the Biden fiscal stimulus augurs strongly for the US, both to spur aggregate demand and underpin recovery with strong investment in infrastructure.

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.

[12] 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 seems likely to 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.

[13] The basic sources are Macrobond, Saul Eslake, and Llewellyn Consulting.

The projected figure for Q1 2021 for Japan is that of the Japan Center for Economic Research. 2021. *Real GDP Growth Outlook for 2021 Q1 公益社団法人 日本経済研究センター:Japan Center for Economic Research*. [online] Available at: <https://www.jcer.or.jp/english/esp-forecast> [Accessed 6 May 2021].

The projected figure for Q1 2021 for the UK is that of the National Institute of Economic and Social Research. See NIESR. 2021. [online] Available at: <https://www.niesr.ac.uk/sites/default/files/publications/Monthly_GDP_%20Tracker_April2021FullDocument.pdf> [Accessed 6 May 2021].