

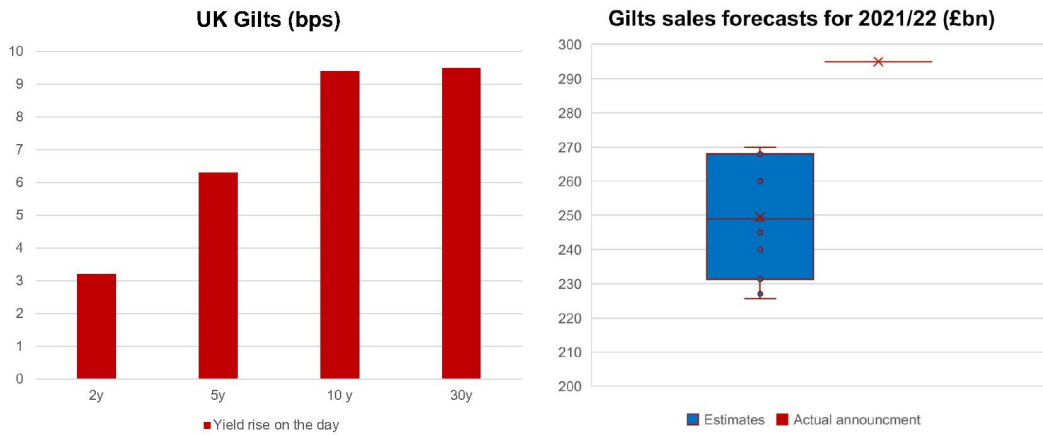
State of the Economy: Financial Markets

9 March 2021

Name Redacted

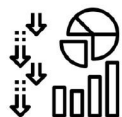
Debt and Reserves Management, Fiscal

The gilt yields curve rose and steepened in response to Budget



Larger than expected forecasts for government borrowing increased gilt yields by up to 10 bps

Key Themes



Inflation worries have led to a significant **rise in sovereign bond yields** and increased volatility.



Economically sensitive assets have outperformed in response to the reflation trade



UK monetary policy outlook has tightened in line with international peers.

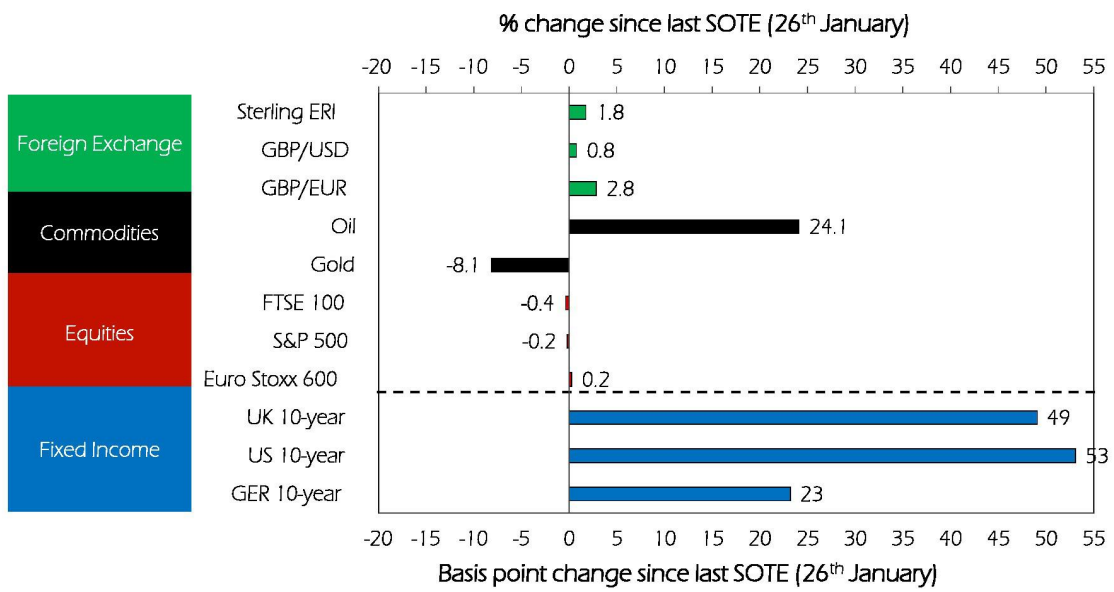
It has been a busy six weeks in financial markets since the last state of the economy.

Inflation worries have helped push core sovereign bond yields significantly higher, with bouts of increased volatility off the back of the pace of the repricing.

The inflation trade has led to mixed results for key assets, but assets more sensitive to the performance of the real economy have outperformed.

In response to inflation concerns and Monetary Policy Committee members' comments, the outlook for monetary policy has tightened in the UK.

Key Asset Price Moves



Key Themes



Inflation worries have led to bond market volatility with a **significant rise in yields**

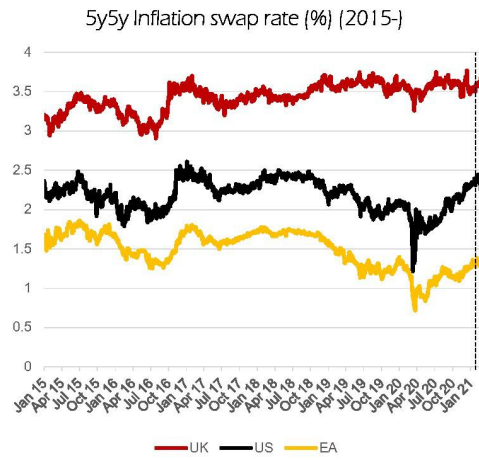
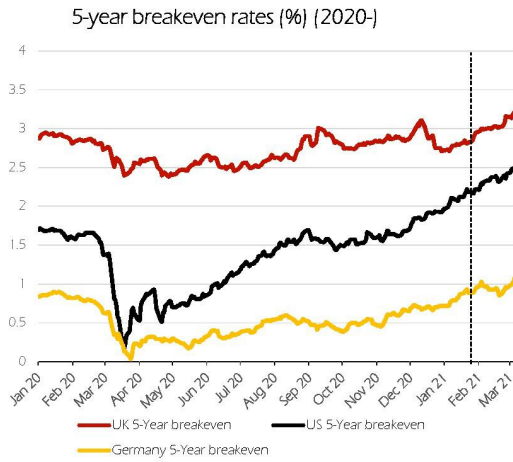


Economically sensitive assets have benefitted from the reflation trade



UK monetary policy outlook has tightened in line with international peers.

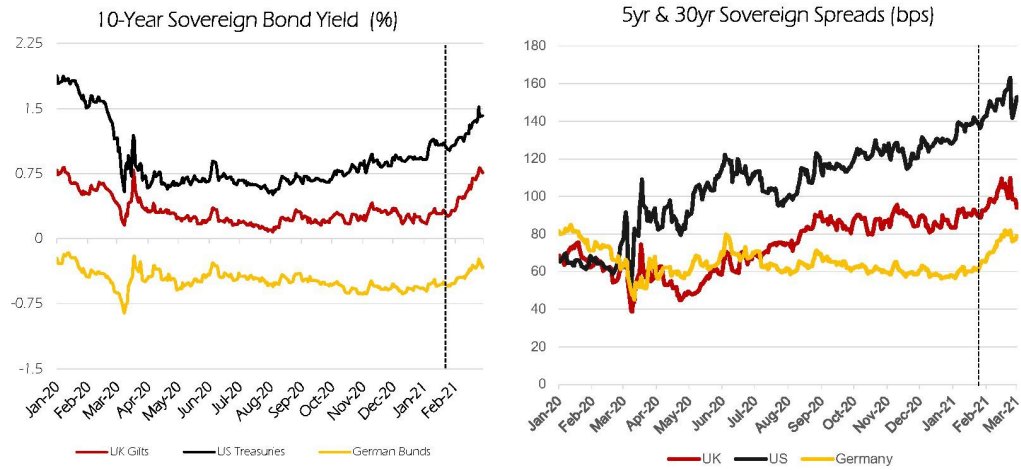
Economic optimism and fears of excessive stimulus have boosted inflation expectations considerably



*UK rates use RPI while the US and Germany use CPI, so can't directly compare inflation rates between the UK and other countries

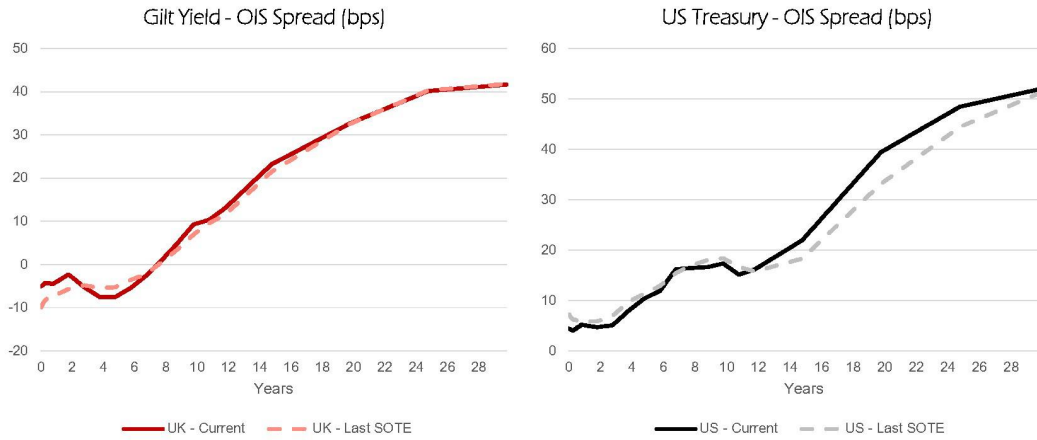
Despite the rise in medium term inflation expectations, inflation is expected to stay below its long-term path.

Core sovereign bond yields have risen and steepened in response to rising inflation expectations and economic optimism



The UK yield curve is at its steepest level since December 2018

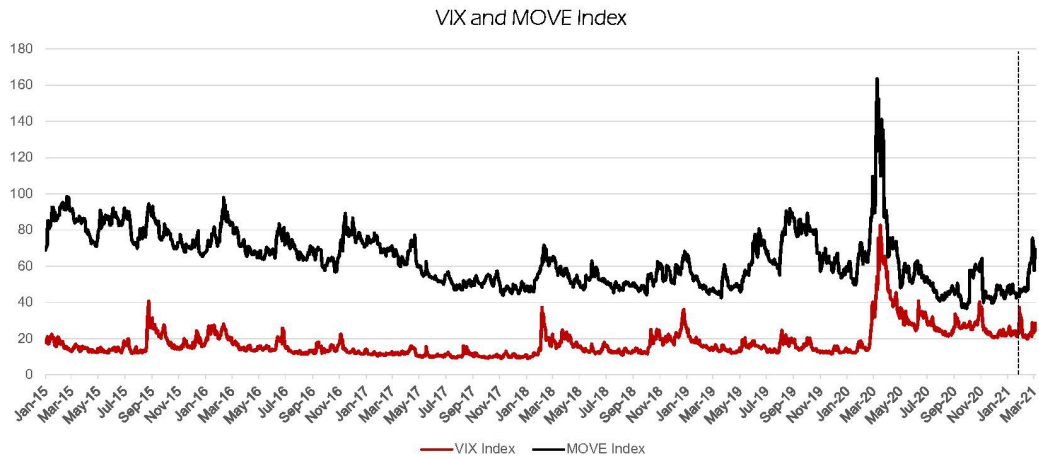
Yields have risen in tandem with expectations for monetary policy



*A shift to the left in the curves would indicate non-monetary policy reasons were the cause of the rise in yields

The main driver of yield rises has been monetary policy expectations, rather than inflation in itself

The pace of the repricing of bonds has caught markets by surprise, leading to a spike in implied volatility



Volatility remains at levels that could be expected in recent years

Key Themes



Inflation worries have led to bond market volatility with a significant rise in yields

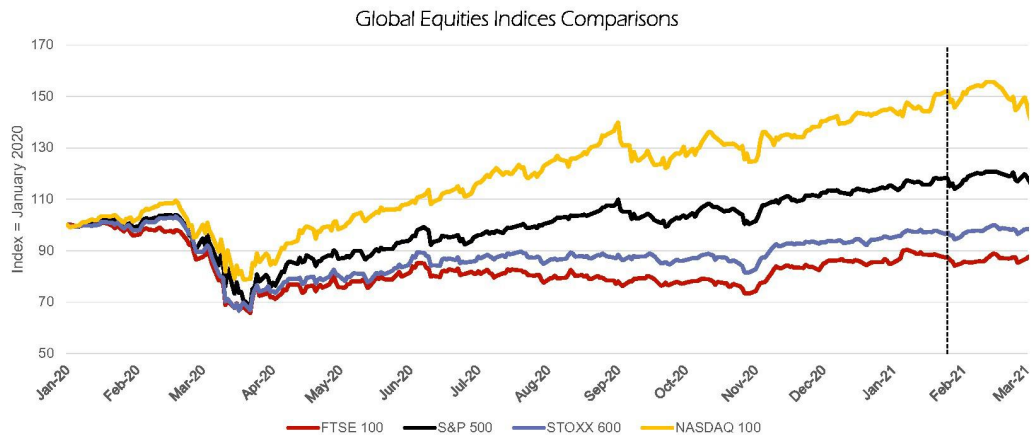


Economically sensitive assets have outperformed from the reflation trade



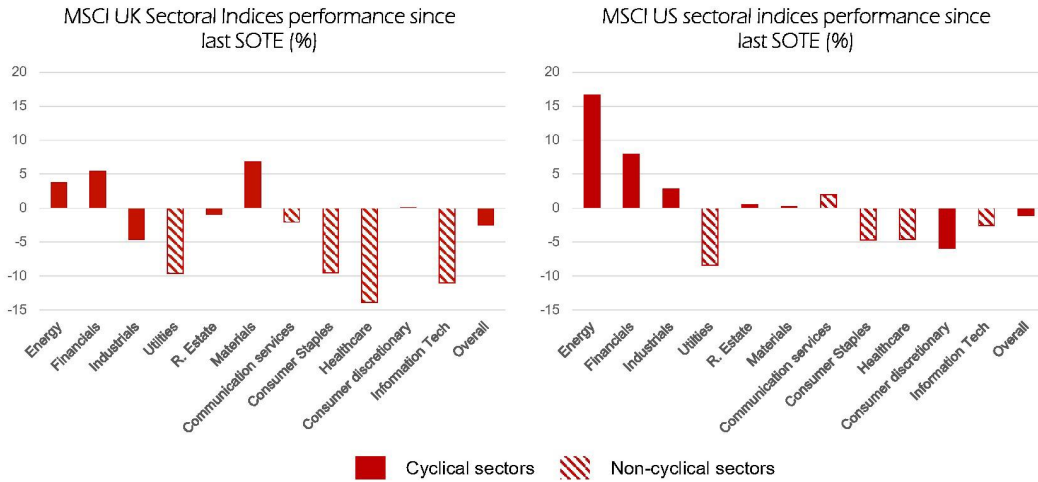
UK monetary policy outlook has tightened in line with international peers.

Equity indices have struggled as investors weigh up the benefits of a stronger economy against higher yields in safe assets



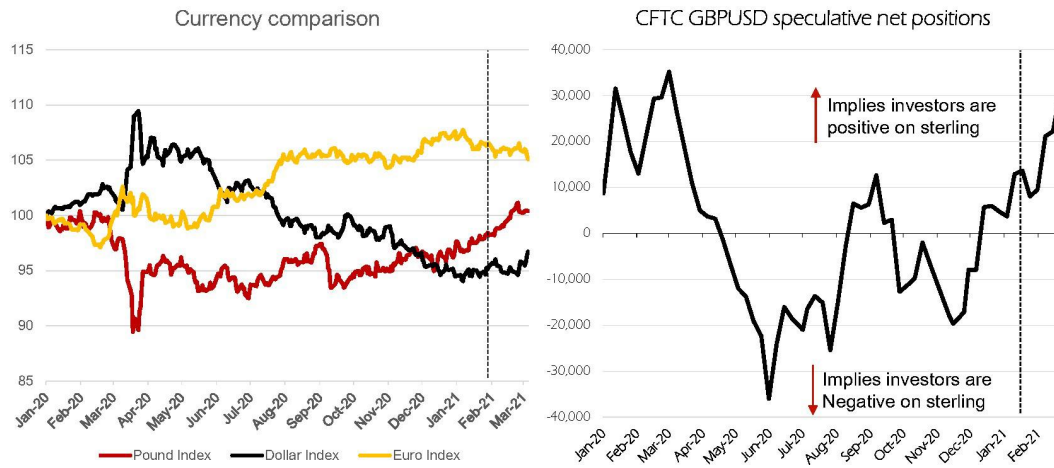
Equities have struggled due to rising discount values

Equities in economically sensitive sectors have outperformed



Prospects for faster economic growth, driven by vaccination rates, have helped cyclical sectors outperform

Sterling has continued to appreciate at a rapid pace following the agreement of the trade deal with the EU.



GBPUSD has reached the upper end of estimates in December for a trade deal scenario with the EU

Key Themes



Inflation worries have led to bond market volatility with a significant rise in yields

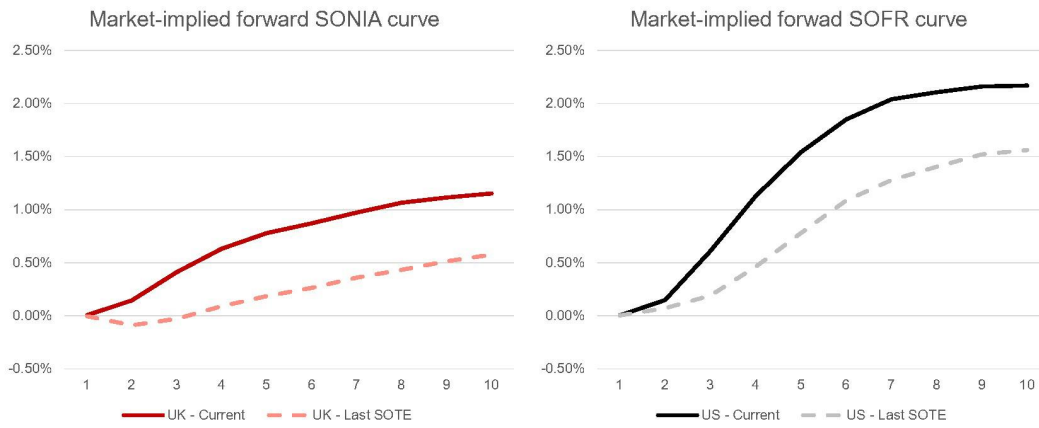


Economically sensitive assets have benefitted from the reflation trade



UK monetary policy outlook has tightened in line with international peers.

UK monetary policy outlook has tightened significantly in line with international peers



Bank Rate is expected to rise to 0.25% in late 2022

Key Takeaways



Optimism around a global economic recovery, along with fears of excessive inflation, **has increased bond yields.**



Sterling outlook is less volatile since the UK-EU trade deal, **with recent moves being driven by US dollar weakness.**



UK monetary policy outlook has tightened, **with negative rate no longer priced in.**

Domestic Economy

Name Redacted

Macroeconomic Assessment, Economics Group

Key themes- Road to Recovery



OBR forecast

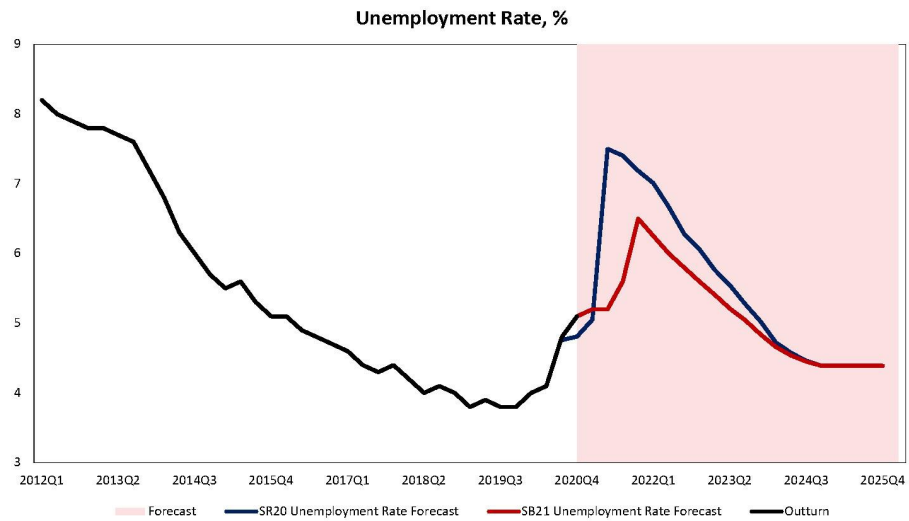


Road to Recovery – Positive signs ahead



Road to Recovery – Challenges ahead

Labour Markets– OBR Forecast



 HM Treasury

The OBR have revised down their unemployment rate forecast

The unemployment rate rose by 1.3ppts on the year to stand at 5.1% at the end of 2020, and its expected to rise further in 2021. The OBR forecast the unemployment rate to peak at 6.5% at the end of 2021, corresponding with the end of the CJRS, and then to gradually fall to 4.4% by the end of 2024.

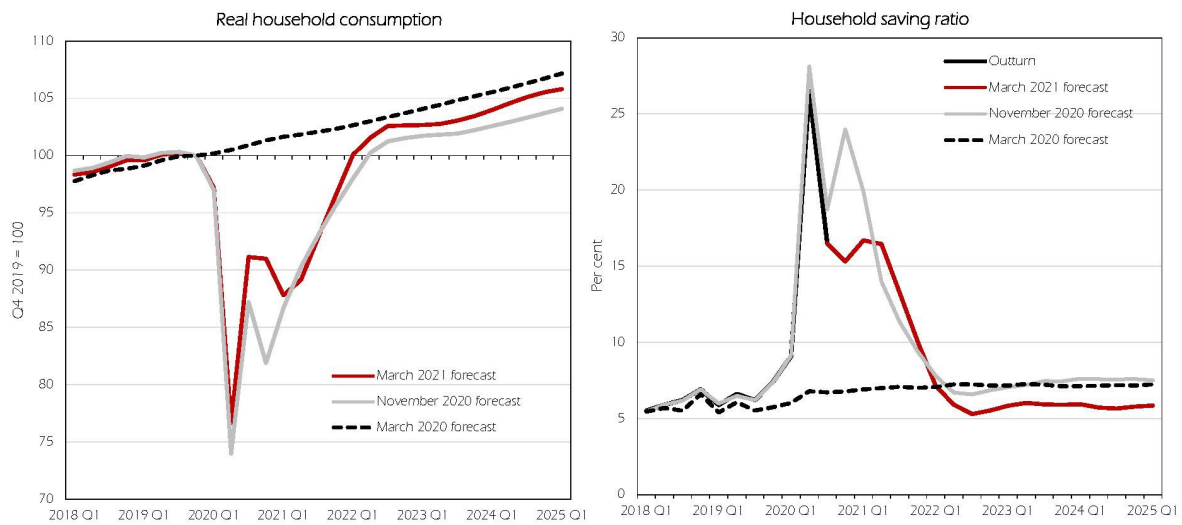
At the peak unemployment rate, the OBR expect 1.8 million fewer people to be out of work than they previously estimated in their central scenario in the July 2020 FSR. In their EFO, the OBR noted that "Without the short-term fiscal easing announced in the Budget, and in particular the CJRS extension, we estimate that unemployment might have been around 400,000 higher in the second quarter of this year". They also directly noted that the government support is what drove the flattening and shifting of the unemployment rate peak - "This is largely due to the extension of the CJRS and the additional fiscal support measures, which extend further into the vaccine rollout, when more sectors of the economy have reopened, and the recovery in activity is more advanced."

Notes -

Labour Market statistics from the ONS showed that in the three months to December, the unemployment rate (16+) rose by 0.4ppts on the quarter and 1.3ppts on the year to 5.1%, while the employment level (16+) fell by 114,000 on the quarter and by 541,000 on the year to 32.4m.

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Households and consumption – OBR Forecast



 HM Treasury

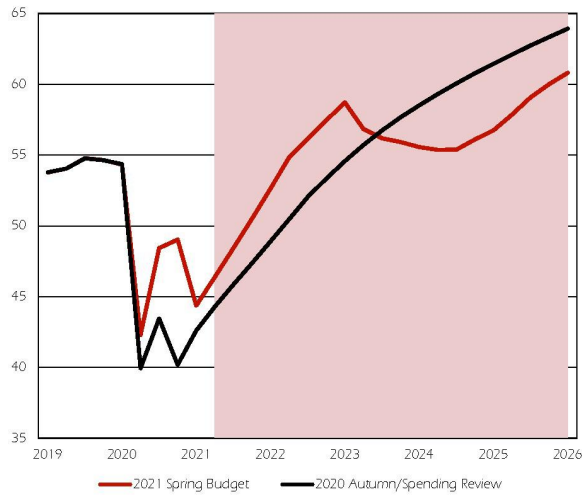
(LHS) Faster recovery in consumption compared to Nov-20. Restrictions lifted enable bounce back in spending, with OBR assuming hh spend 25% of the savings they have built up during the pandemic over the forecast period.

(RHS) hh saving ratio falls in line with increase in spending as restrictions ease from Q2 2021, with hh incomes remain relatively resilient (largely due to government support). Unwinding of excess savings means saving ratio slightly lower than in the medium run than previous forecasts.

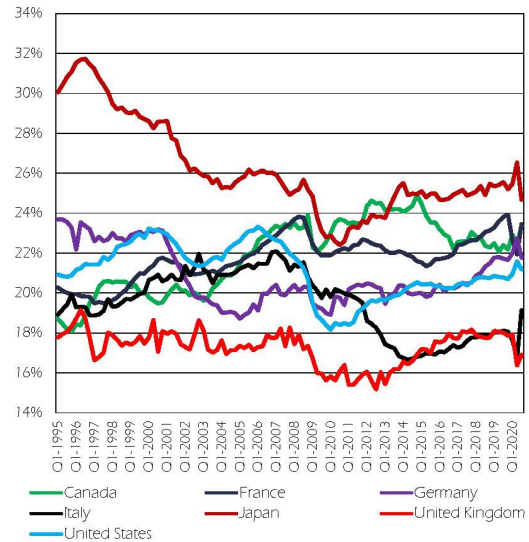
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Corporate Sector and Trade – OBR Forecast

Business Investment (CVM, SA; ONS series NPEL), £ billions



Total GFCF across G7 countries (OECD), % of GDP



HM Treasury

Business investment lines

When compared to the November forecast, the OBR's 2021 Spring budget forecast indicates a sizeable increase in Business investment in the near and medium term. The OBR attributed the faster recovery to greater clarity over the implications of Brexit and growing confidence about the medium-term outlook. A further support for business investment was the increase in capital allowances announced on the Budget, which have the effect of bringing forward investment from future periods. From 2023-24, the Government's announced CT increase alongside capital allowance's returning to their original amount, will have a negative impact on business investment.

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Key themes- Road to Recovery – positive signs



OBR forecast

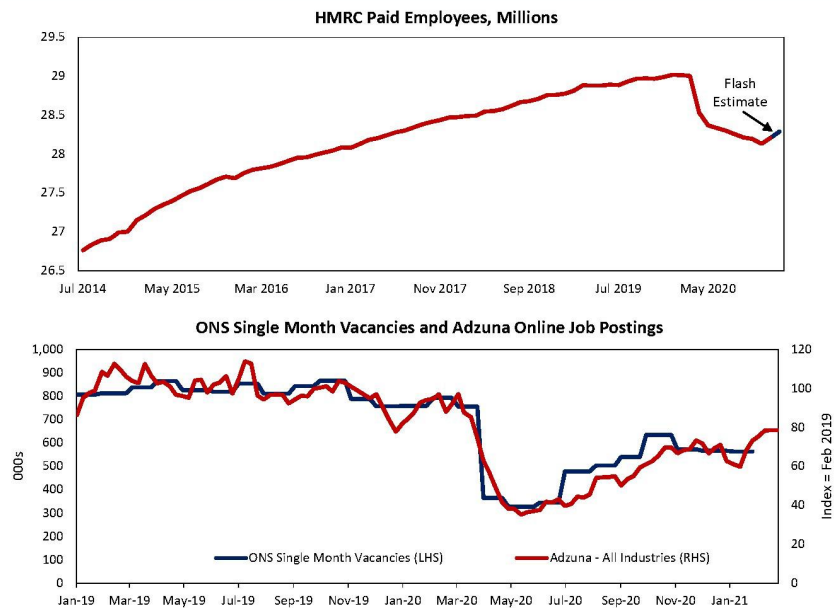


Road to Recovery – positive signs



Road to Recovery – Challenges ahead

Labour Markets-- Road to Recovery – positive signs



HM Treasury

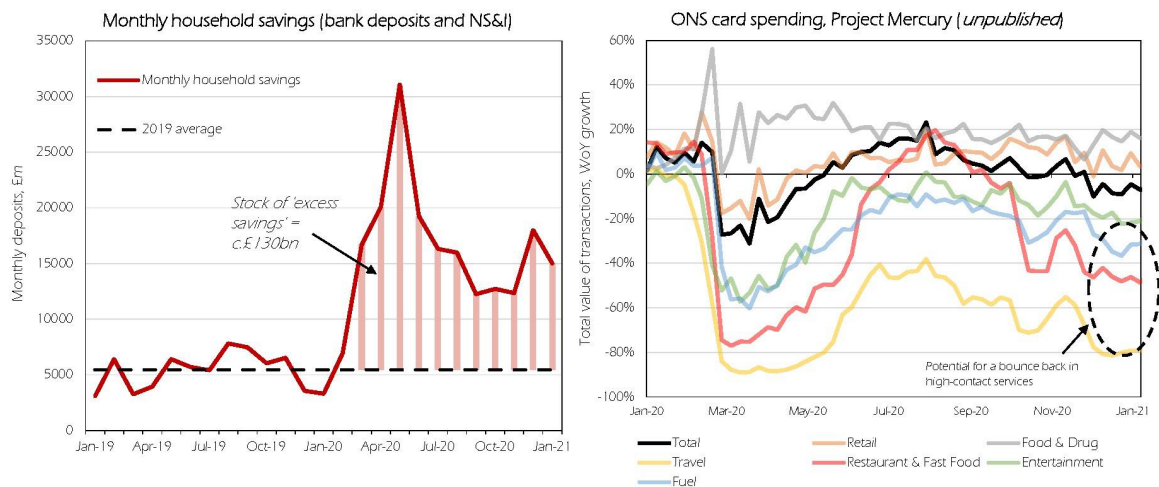
Several LM data sources suggest the LM has remained much more resilient during the latest national lockdown.

Potential signs of increase in paid employees: HMRC PAYE data shows the number of employees on payroll has fallen by 726,000 between February 2020 and January 2021, however, there are signs that the number of employees is starting to increase from its trough. Flash data for January shows the number of paid employees increased by 83,000 on the month, marking the second consecutive month of increase. The rise in January is particularly encouraging given it came during a national lockdown.

Vacancies are well up from their trough last year: Vacancies and online job postings fell by 50-60% in April-May, and have gradually risen since. Despite a slight decline in early January, online job postings are 88% up on the trough in May. The latest data by the ONS shows that single-month vacancies fell marginally on the month in January (-0.5%) and are 26% lower on the year. Though this recovery is not even across sectors, with single-month vacancies in the accommodation and food sector down 90% on the year. To note, this series is NSA.

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Households – Road to Recovery – positive signs



 HM Treasury

(LHS) According to Bank of England data on household deposits, households have accumulated around £130bn in excess saving since March 2020. The OBR forecast the total stock of additional saving to reach around £180bn by the middle of 2021. This suggests households are in a good position to ramp up spending once restrictions are lifted – upside risk to consumption. Evidence also suggests additional household savings have been held primarily in liquid form, potentially allowing them to be run down more easily than usual.

(RHS) willingness to go and spend, pace of vaccine roll out – potential for a strong bounce back in social spending as restrictions are lifted. There was a bounce back in spending last summer as restrictions were lifted, whilst survey evidence from YouGov suggests households feel more comfortable visiting public places (e.g. cafes, restaurants and bars) than they were after the first lockdown. Social consumption also makes up a larger share of total consumption in the UK than in many other advanced economies, so potential for sharper bounce back.

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Key themes- Road to Recovery – Challenges ahead



OBR forecast

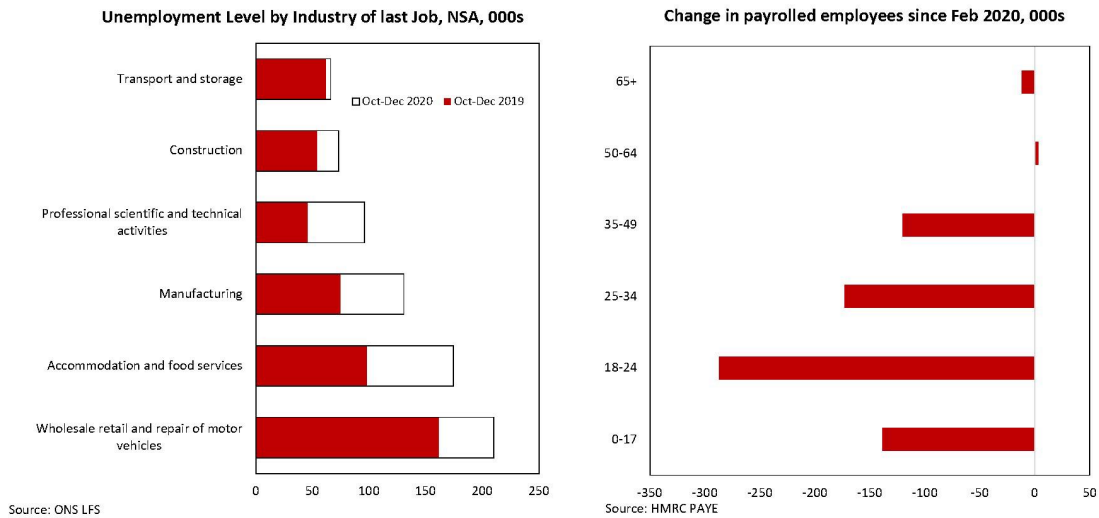


Road to Recovery – positive signs



Road to Recovery – Challenges ahead

Labour Markets-- Road to Recovery – Challenges ahead



The young and those previously working in consumer-facing businesses have been disproportionately impacted

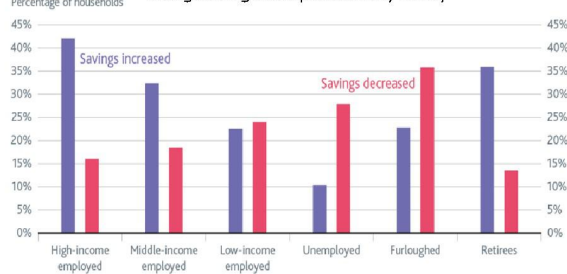
Young people continue to be impacted: According to the RTI data (RHS chart) young people (16-24) accounted for 59% of the fall in paid employees since February, whilst those aged 25 to 49 accounted for 40%. Young people are also more likely to be furloughed, as they tend to work in sectors which have been heavily impacted by NPIs, such as accommodation and food. Literature suggests that young people are the age group most at risk of labour market scarring and that this risk increases during recessions. Young people are disproportionately impacted by recessions, and that this recession is likely to be no different.

Social consumption sectors are also heavily impacted: The accommodation and food services and wholesale and retail sectors have experienced largest drops in paid employees since February - 345,000 and 149,000 respectively. Those previously employed in the accommodation and food services sector experienced the largest rise in unemployment on the year (+77,000 or 5.3ppts) to 10.6%.

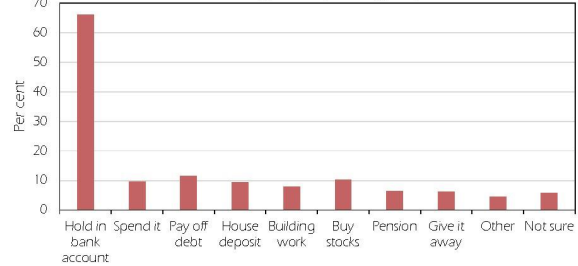
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Households – Road to Recovery – Challenges ahead

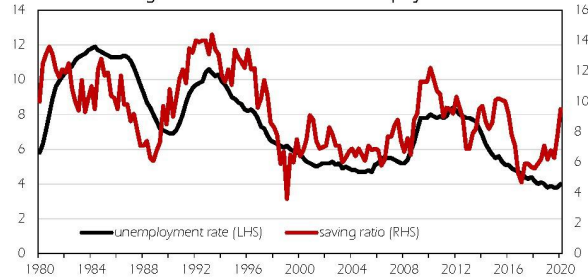
Higher-income households are more likely to have increased their savings during Covid (source: BoE / NMG)



BoE/NMG survey responses on what households plan to do with additional savings built up during the pandemic



Saving rates tend to increase with unemployment



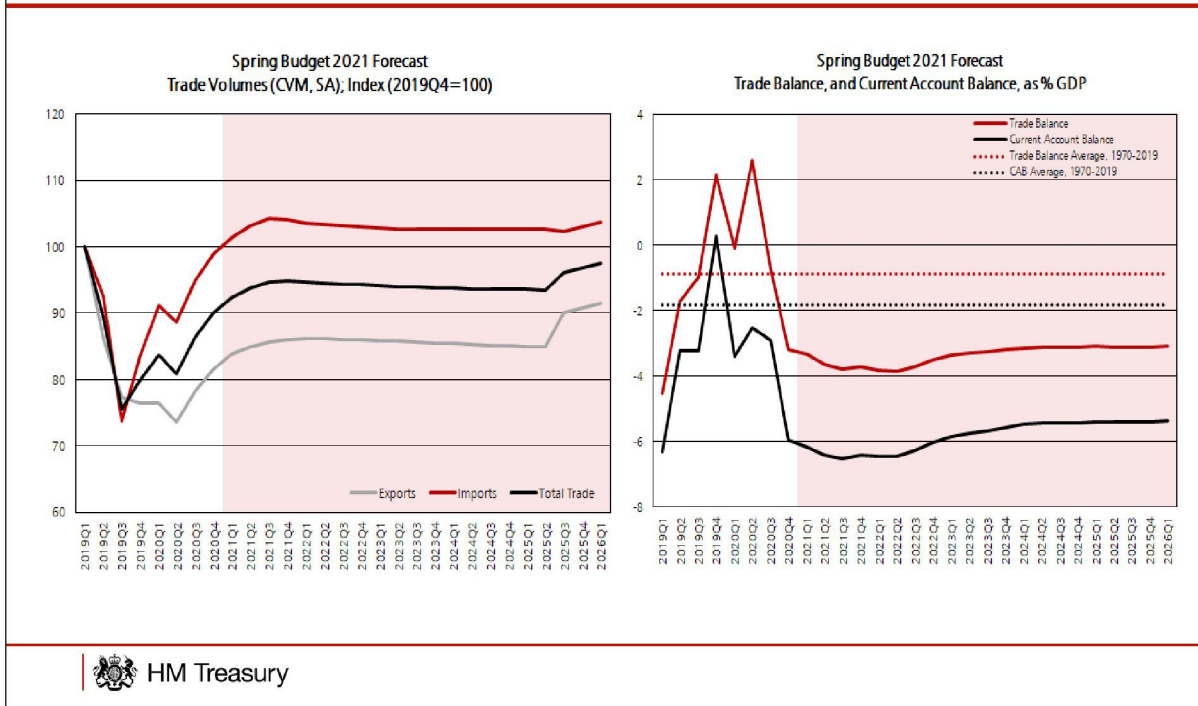
Savings concentrated among higher income households, who typically have a lower marginal propensity to spend out of wealth. A recent Bank of England survey found that 42% of high-income households have saved more during the pandemic, compared to 23% of lower income households. These households may be less likely to spend their savings in support of the recovery: higher-income households tend to spend a smaller fraction of their income, both on average and in response to a positive shock to their finances.

What do hh plan to do with their savings? BoE NMG survey – found that only 10% of households that have saved more during the pandemic plan to spend them. 70% planning to retain them in their bank account

Unemployment concerns: concerns over future unemployment remain relatively high. Unemployment has remained fairly low to date, meaning reduced consumption is yet to materialise, however, an unemployment rate peak later this year potentially poses a downside risk to demand.

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Corporate Sector and Trade – Road to Recovery – Challenges ahead



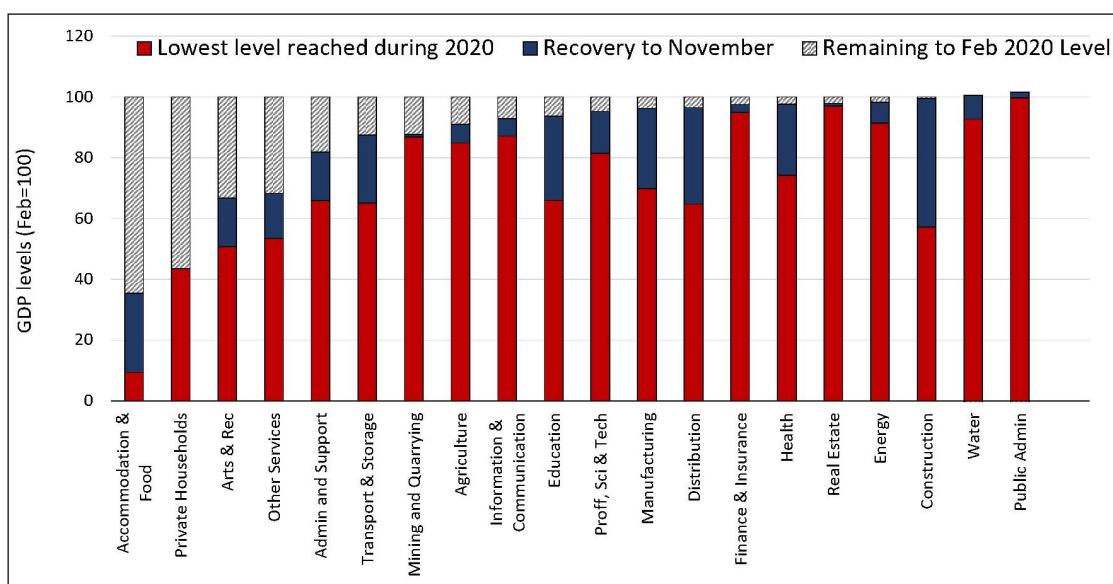
UK trade performance is likely to be one of the key challenges during the recovery period and beyond. Trade and trade openness is linked to knowledge spillovers, long-run productivity and living standards.

The first chart shows the forecasted path for trade volumes relative to the pre-pandemic (2019Q4) level. There has been some trade disruption in recent months due to Coronavirus restrictions and the end of the transition period, which the OBR think will knock 0.5% off GDP in 2021Q1. Disruption should dissipate after Q1, but trade is expected to remain subdued in the medium-term as well. Total trade in goods and services in real terms never recovers to the pre-pandemic level during the forecast period. Imports are forecasted to return to the pre-pandemic level in 2021, but exports recover far more slowly.

The trade deficit and current account deficit are also expected to remain at historical highs throughout the forecast period, as shown in the second chart. The current account deficit peaks at 6.5% in 2021Q3 before easing slightly to 5.4% by the end of the forecast period; this compares starkly to the historical average of only 1.8%. A small current account deficit is sustainable with continued net capital inflows, but there are risks associated with a larger deficit over time, e.g. the value of sterling.

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GDP-- Road to Recovery – Challenges ahead



 HM Treasury

[from EFO] "Uncertainty around the economic outlook remains considerable, with the course of the pandemic still the greatest single risk. A quicker rollout of vaccines with greater effectiveness in reducing infection and illness, the development of new therapies and treatments, or a faster rundown in household savings built up during the pandemic could deliver a swifter economic recovery and less medium-term scarring."

Against that, setbacks in the rollout of the vaccines, the emergence of new vaccine-resistant variants, or reduced compliance with residual public health restrictions could force governments back into periodic lockdowns, with more adverse consequences for the economy in the short and medium term.

For the near term – one promising sign for the 'road to recovery' has been the apparent adaptability of people and business to Covid restrictions. [From Budget] Nearly every sector fared better in November than April 2020, though some sectors were particularly improved, reflecting both more targeted restrictions and businesses having adapted. Manufacturing, construction, distribution and public sector output were all significantly higher in the second lockdown than the first (See chart).

In November, 11% of firms reported they had temporarily paused trading, compared to 24% in the first two weeks of the first national lockdown in April. This was the case even for heavily affected sectors. For example, 45% of firms in the accommodation and food services sector reported that they were open in November, compared to 18% in early April, possibly reflecting adaptation to the way they deliver their services, such as by offering takeaway services.

Test and Trace as well as vaccines activity also poses some short-term upside risk in a more direct sense for GDP output, since these activities will be reflected in health output. Headline GDP growth in Q4 2020 was actually driven to a large degree by the test and trace scheme, and the ONS' attempts to account for it in the National accounts. The ONS have not explicitly confirmed how they will treat the vaccine rollout yet, however the positive contribution from the health is likely to continue throughout 2021 (although will unwind eventually as health metrics improve).

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Global Economy

Name Redacted

European Economics, International Group

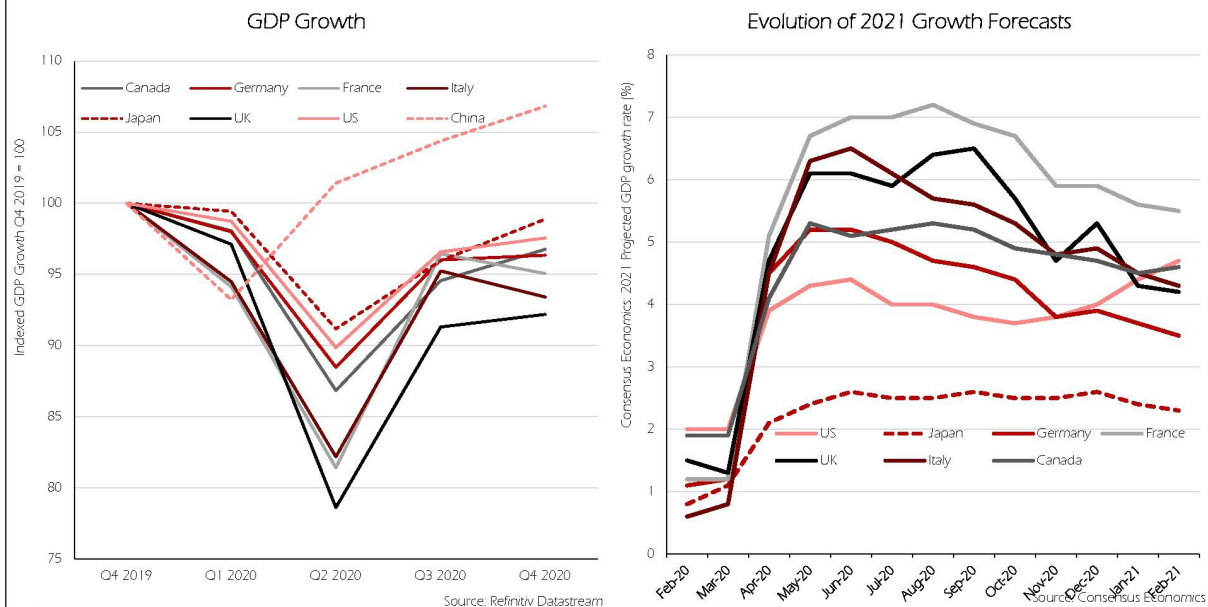
Themes

1. **Global growth and trade: an uneven global recovery, risks and uncertainties remain**
2. **Uneven fiscal response: UK and US provide large fiscal responses, countries publish recovery plans of varied size and focus**
3. **Risks: COVID-19 has exacerbated existing inequalities, while EMs also face risks from policy spillovers and inflation; increased corporate debt poses risks**

Themes

1. **Global growth and trade: an uneven global recovery, risks and uncertainties remain**
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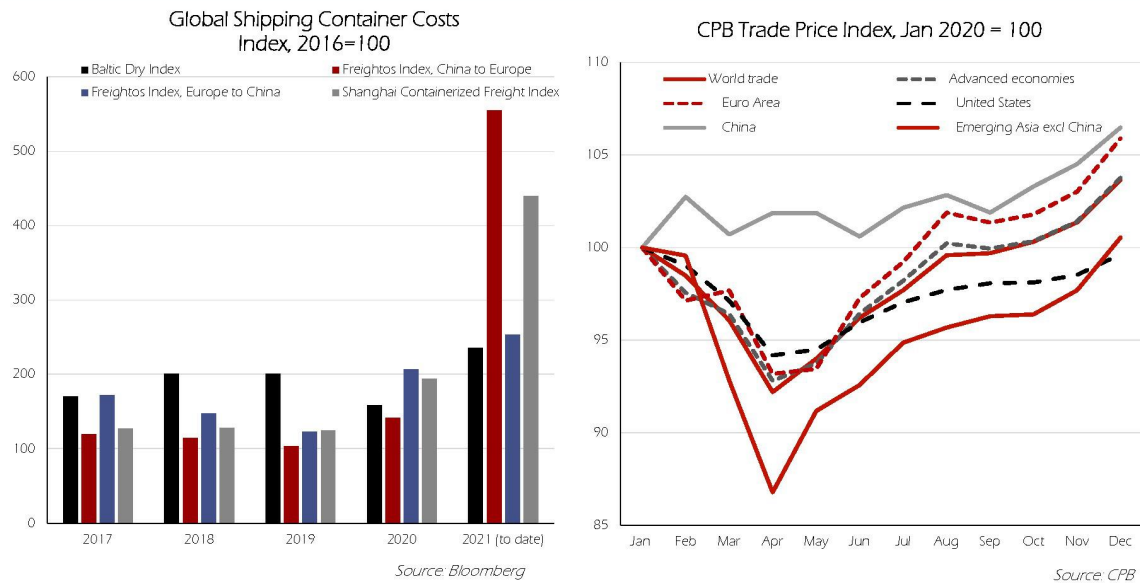
Global recovery has so far been uneven; with an uncertain path according to forecasts



LHS
 Real GDP for the UK and other advanced economies contracted following the onset of the pandemic in Q12020, partially recovering in Q3 then being weighed down again by renewed mobility restrictions in several economies following a surge in cases in Q3 —likely amplified by new variants of the virus in some places.
 UK's contraction overall was the largest at 9.9% in 2020, larger than Italy, France and Germany. The US is an outlier, contracting by only 3.5% in 2020.
 As we've seen before, some of the UK's underperformance can be attributed to differences in approaches to measurement; [in nominal terms, where these differences are less acute, UK GDP declined 4.8% in 2020.]
 China's growth has remained resilient throughout the pandemic, greatly outperforming advanced economies, [and is now 6.8% higher than pre-crisis levels.]

RHS:
 Growth forecasts for 2021 have trended downwards since late last summer, as the second wave of COVID-19 cases and renewed restrictions hit Europe's major economies
 The US is an exception to this trend, with the election of President Biden pushing 2021 forecasts up in the US since November, as the prospect of a further stimulus package worth \$1.9tr presents more reasons to be optimistic about US growth this year.

Driven partly by increased demand for goods, shipping costs and world trade prices increase



Trade: increased shipping costs and increased world trade prices

LHS

As a result of continued increased demand for goods, health precautions and Covid-19 cases amongst port workers, the shipping container shortages seen in 2020 continue.

Container shipping costs data saw an increase in costs for all indices and are considerably higher than the annual average for the indices in 2016.

As you can see from Freightos Index data, the cost of shipping goods from China to Europe has now quadrupled compared to the pre-pandemic level.

This causes a risk of further inflation if this trend continues. However, inflation expectations may fall if demand for containers drop as consumers revert to spending more on services as restrictions are lifted.

RHS

Increased consumer demand is having knock-on impacts for supply chains increasing prices, with for example the demand for consumer electronics, boosted by the pandemic, leading to shortages in the semiconductor industry, and the automotive industry particularly affected.

According to CPB data, world trade prices increased by 2.3% in December from 1% in the previous month, with price growth driven by an increase in export prices for emerging Asian economies excluding China [of 4.3% in December compared to the previous month.]

LHS chart –

Shipping container shortages seen in 2021 continue as a result of continued increased demand for goods and health precautions and Covid-19 cases amongst workers at ports around the world.

As a result, container shipping costs data saw an increase in costs for all indices and are considerably higher than the annual average for the indices in 2016. Indexed to 2016, thus far in 2021 the:

Baltic Dry Index which provides a benchmark for the price of moving the major raw materials by sea taking into account 23 different shipping routes carrying coal, iron ore, grains and other commodities is at 235.1.

Freightos Index China to Europe based on aggregated and anonymized real-time business data from global freight carriers,

freight forwarders, and shippers is at 554.5. The index covers door-to-door rates for ocean freight. Shanghai Containerised Freight Index which captures the fluctuation of spot freight rates on export container transport market from Shanghai by a weekly survey is 439.3.

Freightos Baltic Dry Index data shows that the cost of shipping goods from China to Europe has now quadrupled compared to the pre-pandemic level and is nearly six times as high as the annual average in 2016.

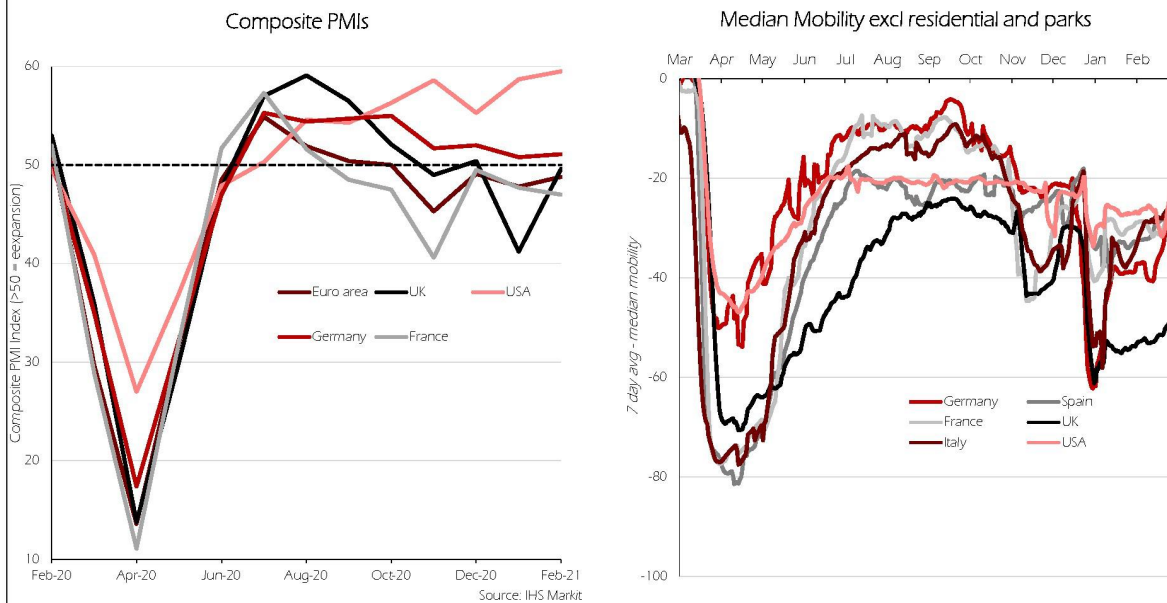
The Baltic Dry index and the Shanghai Containerised Freight Index have continued the upward trend observed since May 2020. However, prices may fall if demand for containers drop as consumers revert to spending more on services as restrictions are lifted.

RHS chart –

The demand for consumer electronics has been boosted by the Covid-19 pandemic. This has led to shortages in the semiconductor industry which are having knock-on impacts for supply chains increasing prices, with the automotive industry particularly affected.

According to CPB data, world trade prices increased by 2.3% in December from 1% in the previous month. Unsurprisingly given that 80% of semiconductor capacity now comes from Asia, price growth has been driven by an increase in export prices for emerging Asia economies excluding China of 4.3% in December compared to the previous month.

While relatively strong PMIs indicate the greater resilience of business to renewed restrictions



PMIs

LHS
 On the left, composite PMIs indicate the greater resilience of business to renewed restrictions on activity. PMIs have remained relatively strong in the second European lockdown compared to the first – the UK's PMI dipped to 41.2 in January compared to 13.8 in April, whilst Germany's PMI has continued to record an expansion through the entire second wave.

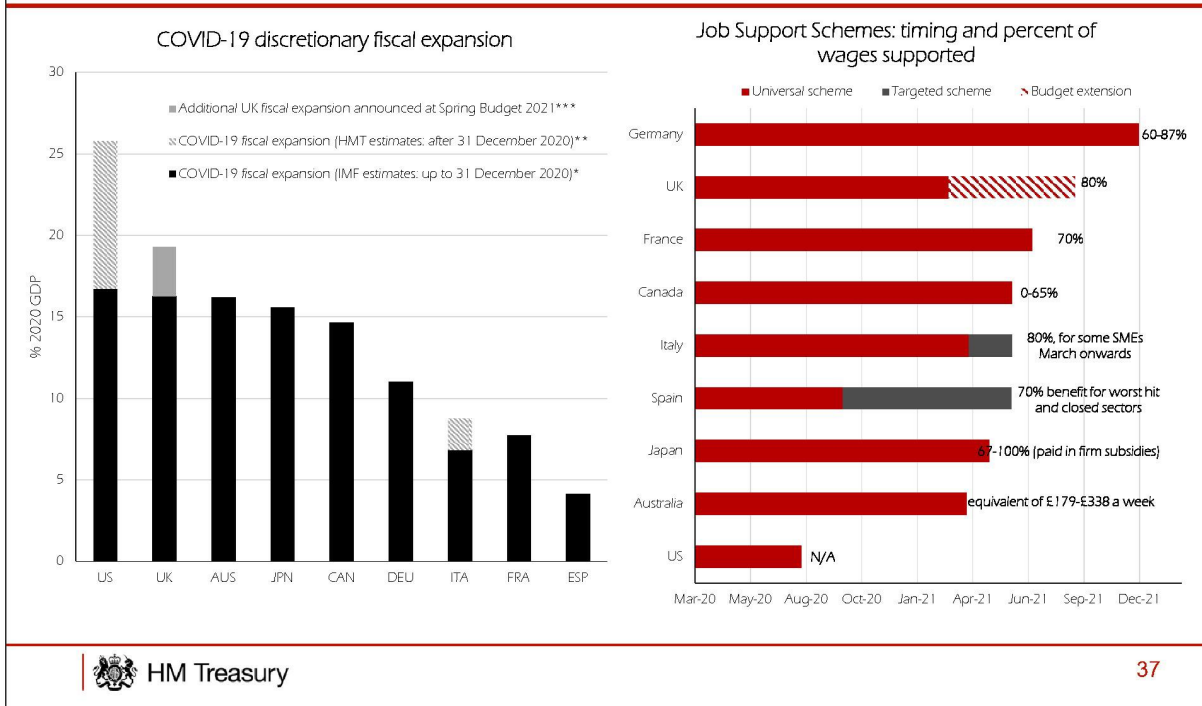
The US is a clear outlier, with its Composite PMI increasing to 59.5 in February – a near 7 year high.

RHS
 This mobility data shows a recent return in activity for most of these countries following a fall in January, despite no large changes in restrictions; the UK is an outlier, likely due to a combination of factors including a greater share of jobs that can be performed remotely, and a longer/stricter lockdown.

Themes

1. Global growth and trade: an uneven global recovery, risks and uncertainties remain
2. **Uneven fiscal response: UK and US provide large fiscal responses, countries publish recovery plans of varied size and focus**
3. Risks: COVID-19 has exacerbated existing inequalities, while EMs also face risks from policy spillovers and inflation; increased corporate debt poses risks

While the UK's response at budget was amongst the largest in the world...



LHS
The UK has introduced one of the largest and most comprehensive fiscal packages globally. The UK's discretionary fiscal expansion in response to COVID-19 amounted to 16.3% of GDP as of 31 December 2020, according to the IMF, incorporating recently proposed measures, including those taken at the Budget, the UK's remains one of the largest and most comprehensive fiscal packages globally.

RHS
UK levels of support via furlough schemes have also been generous by international standards. In March 2020, European and many key comparator countries adopted furlough schemes to provide labour market support. Since then, most have extended and some have targeted their schemes to specific sectors or businesses. With the recent extension, the UK's furlough scheme is now the second longest in the G7, after Germany.
[*The French system covers 70% of gross wages, and Germany's Kurzarbeit cover 60% of employees net wages, increasing to 70% and 80% after 3 and 6 months respectively – with an additional 7 percentage points for parents.]

LH chart footnotes:
* Cumulative discretionary budgeted fiscal expansion (additional spending and foregone revenue) announced by governments in response to the COVID-19 pandemic as of 31 December 2020, from the IMF January 2021 Fiscal Policies Database. Excludes automatic stabilisers and measures proposed in EU countries' draft plans for Next Generation EU financing. Estimates included here are preliminary as governments are taking additional measures or finalising the details of individual measures. Measures are implemented over a varying number of years by country.

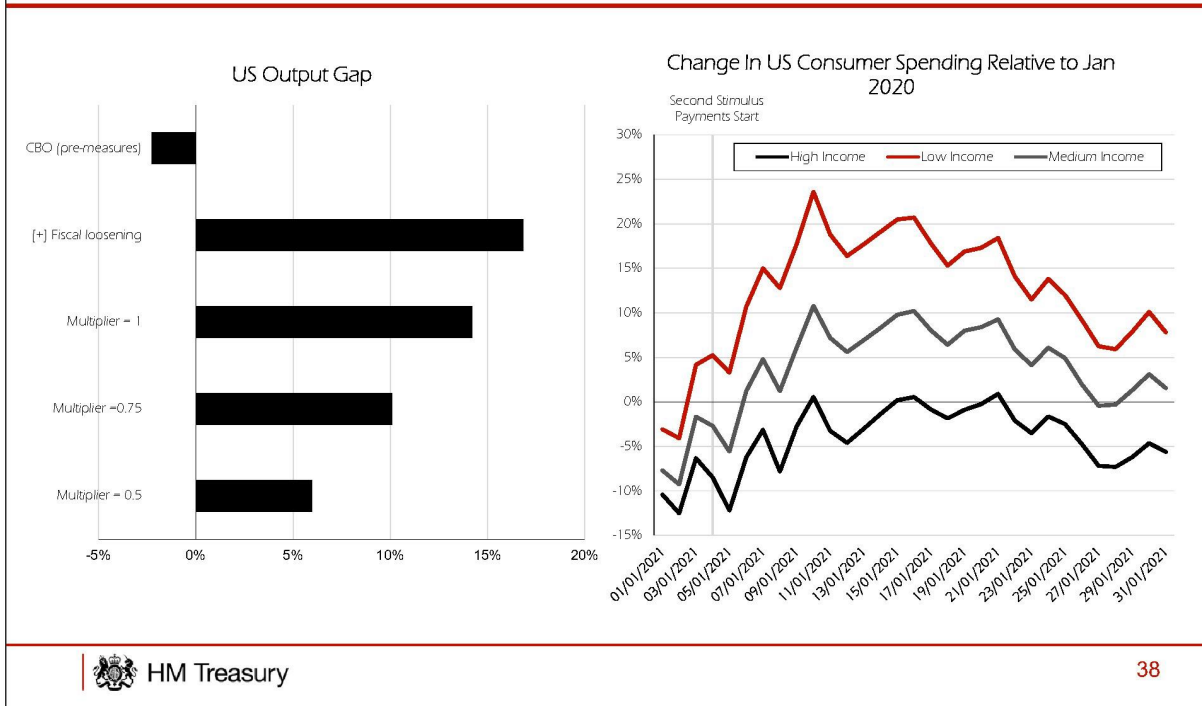
** Additional COVID-19 discretionary fiscal expansion announced for implementation in 2021, estimated by HMT based on government announcements. For the US, this assumes full passage of the proposed \$1.9tn American Rescue Plan package. For Italy, this reflects a €32 billion increase in the debt ceiling for the 2021 budget announced in January 2021. While France and Spain have announced further COVID-19 fiscal measures in 2021, the budget and fiscal impact of these proposals have not yet been published and cannot therefore be included.

*** The additional UK fiscal expansion reflects policy decisions confirmed at this Budget and is equal to the public sector net borrowing impact of policy decisions from this Budget on the scorecard in 2020-21 and 2021-22. While the totals are very similar, for consistency across the dataset the UK fiscal expansion presented in the chart builds on the IMF estimates of COVID-19 fiscal expansion and therefore differs from HMT headline figures for fiscal support due to differences in methodologies.

RH chart:

In March 2020, European and key comparator countries adopted furlough schemes to provide labour market support. Since then, most have extended and some have targeted their schemes to specific sectors or businesses. With the recent extension, the UK's furlough scheme is now the longest in the G7, except for Germany. Overall UK levels of support have also been generous by international standards. The French system covers 70% of gross wages, and Germany's Kurzarbeit cover 60% of employees net wages, increasing to 70% and 80% after 3 and 6 months respectively – with an additional 7 percentage points for parents.

There is concern that the US's even larger fiscal package could lead to inflation



There is concern that the US's even larger fiscal package could lead to inflation.

The overheating debate in the US has centred around Summers and Blanchard's claims that additional spending through Biden's ARP package could lead to inflationary pressures. The main rationale is that the proposed spending of \$1.9tn in the ARP is much greater than the output gap.

LHS

The chart on the LHS shows the CBO forecast for the 2021 output gap, along with the size of the fiscal loosening (as stated by Blanchard), which includes the ARP as well as the additional December spending through the CARES act and excess savings in the US economy.

Even with different sized multiplier effects, the fiscal loosening would be greater than the forecast output gap, so in theory additional spending through the ARP could lead to inflationary pressures.

There are a number of reasons however why this might not be the case. First, output gaps and the true multiplier effect are difficult to predict. Second, the main measure that could lead to inflationary pressure is the stimulus cheques, and there is contention over whether this would be sufficient to overstimulating the economy, as much of this will either replace lost incomes or will be saved. Finally, the Fed's ability to respond to inflationary pressures is key. Fed chair Powell has said they have the tools and space to deal with this, and that as long as inflation expectations remain anchored they do not foresee any issues from increased fiscal spending.

RHS

The RHS chart shows how consumer spending in the US changed in response to the second round of stimulus cheques released in January 2021. The second round of stimulus provided \$600 cheques to individuals earning under \$75,000.

The chart shows that while spending followed similar trends for all income levels, spending by individuals with lower incomes had the greatest relative increase in response to the stimulus cheques. This highlights the need for any future US stimulus to be targeted towards those who need it most.

LHS

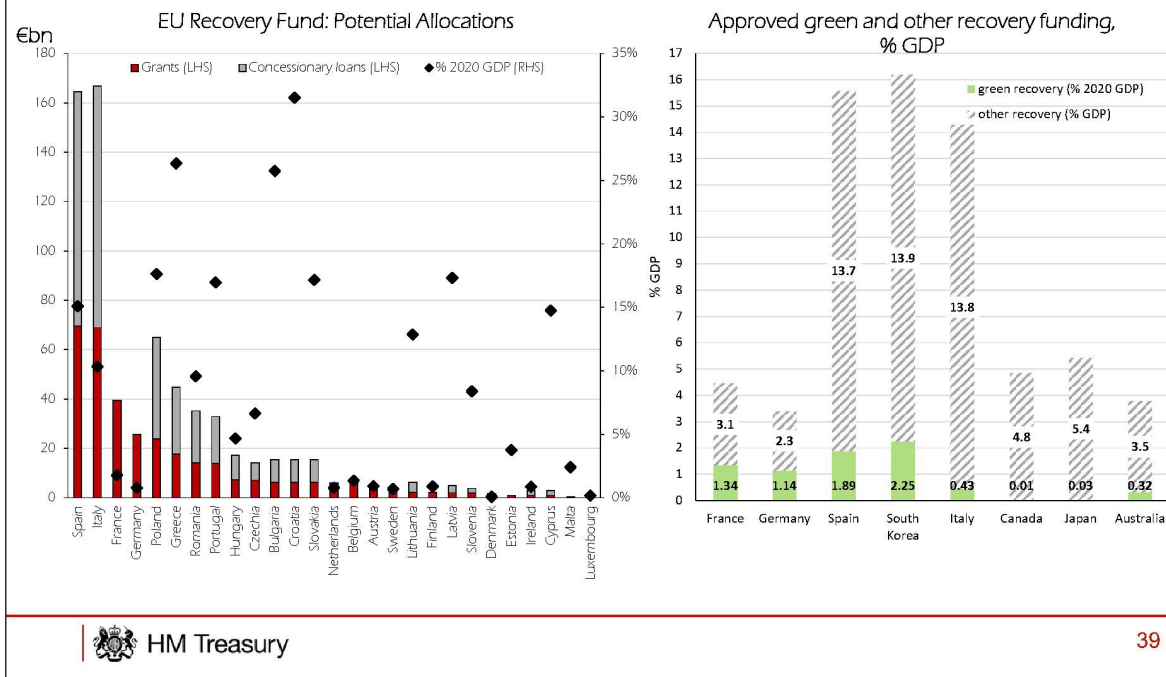
The overheating debate in the US has centred around Summers and Blanchard's claims that additional spending through Biden's ARP package could lead to inflationary pressures. The main rationale being that the proposed spending of \$1.9tn in the ARP is much greater than the output gap. The chart on the LHS shows the CBO forecast for the 2021 output gap, along with the

size of the fiscal loosening as stated by Blanchard, which includes the ARP as well as the additional December spending through the CARES act and excess savings in the US economy. Even with different sized multiplier effects, the fiscal loosening would be greater than the forecast output gap, so in theory additional spending through the ARP could lead to inflationary pressures. There are a number of reasons however why this might not be the case. First, much of the additional stimulus is replacing lost income in the US economy. Second, output gaps and the true multiplier effect are difficult to predict. Finally, the Fed's ability to respond to inflationary pressures is key. Fed chair Powell has said they have the tools and space to deal with this, and that as long as inflation expectations remain anchored they do not foresee any issues from increased fiscal spending.

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Countries are announcing their recovery packages, which vary in size; some focus on green recovery



Onto recovery packages, which countries have been announcing with different sizes and focus.

LHS
 The EU reached agreement on the Next Generation EU recovery fund of €750bn in December, of which €312bn will be allocated to Member States through direct grants, and €360bn available in loans. 70% of the grants have already been allocated, with as you can see on the chart, Spain and Italy set to receive the largest allocation. While this represents a large amount of funding, it has strings attached: national plans presented by Member States for grant funding in April must set out how 37% of expenditure supports the green transition. [these allocations could look different in the end: the remaining 30% will be split according to actual outturn of real GDP growth, and the allocation of loans will depend on how much member states choose to borrow]

RHS
 The left hand chart shows the green recovery funding approved by Parliaments in countries against approved economic recovery funding, pre-budget. While several countries have published their recovery plans, with many speaking of “greening the recovery” from the economic impacts of covid-19, they are at different stages in announcing and approving actionable green recovery packages, and the size of recovery funding announced by comparators varies widely. Despite similar rhetoric on greening the recovery from most of these countries, only France and Germany have allocated around a third of their economic recovery funding on green measures, with other countries currently far behind.

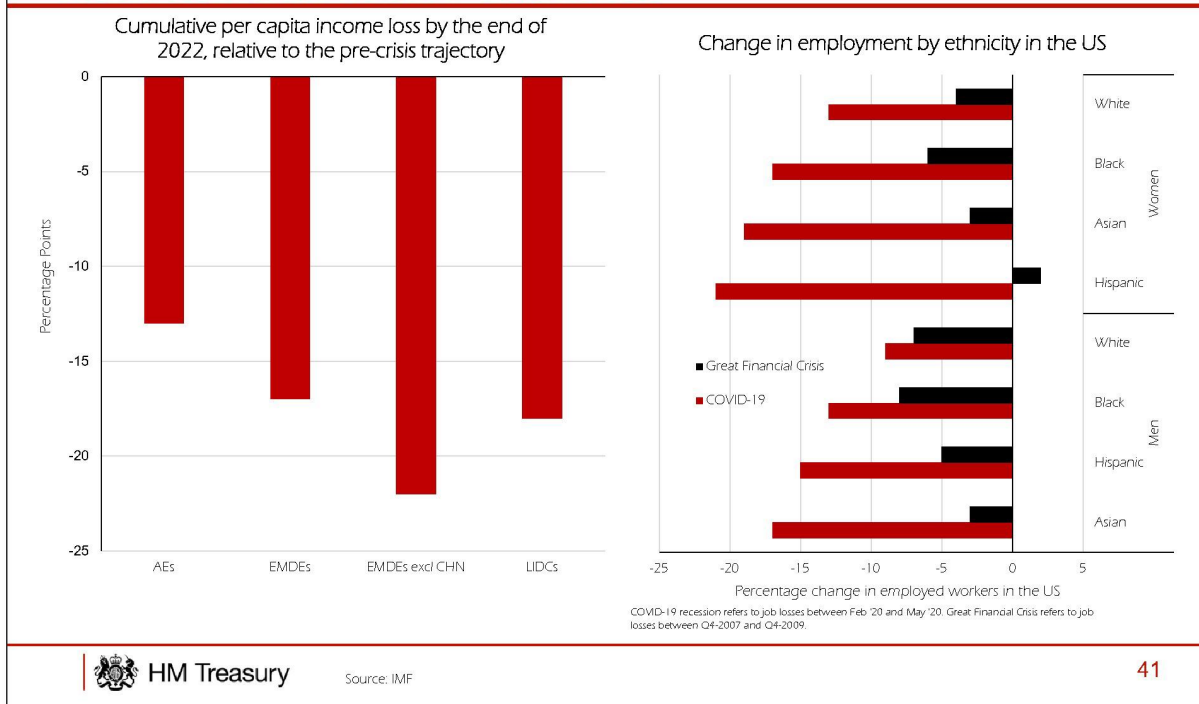
NB: France, Germany, Spain, SK green bars represent approved green recovery plans. Other green bars are the sum of approved and costed green recovery measures to date and expected to rise. Most of these plans are multi-year plans and the funding presented here is the total announced funding; the timeframe varies by country and goes up to 2025.

LHS footnotes
 Loan assumptions: The European Commission hasn’t announced allocations for loans yet – we have assumed that any countries that had borrowed from SURE (temporary loans available for member states to help preserve employment) would also borrow from NGEU and they would borrow the maximum of 6.7% of GNI.

Themes

1. Global growth and trade: an uneven global recovery, risks and uncertainties remain
2. Uneven fiscal response: UK and US provide large fiscal responses, countries publish recovery plans of varied size and focus
3. **Risks: COVID-19 has exacerbated existing inequalities, while EMs also face risks from policy spillovers and inflation; increased corporate debt poses risks**

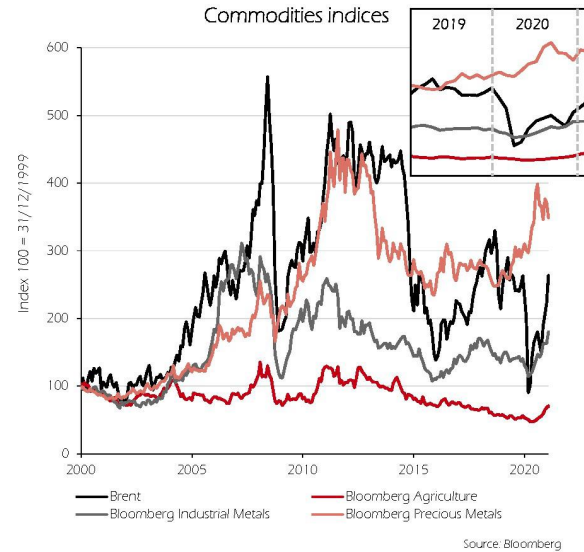
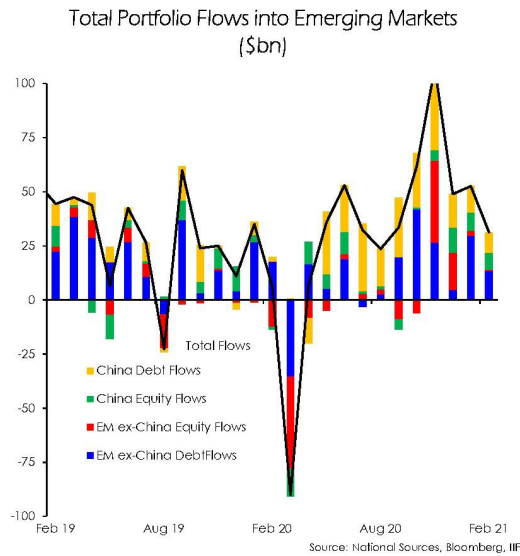
COVID-19 has exacerbated existing inequalities, both between and within countries



LHS
 The chart on the left shows the IMF's forecast for per capita income losses from 2019 to 2022, and shows how emerging markets have been particularly hard hit by Covid-19. This highlights the risk of advanced economies and a selected few emerging markets recovering faster, while other emerging markets and developing countries are left behind. The uneven recovery discussed earlier could worsen this divergence, weighing on global growth. Rising inequality could cause political instability, hamper international cooperation, and slow progress towards development goals. The divergence can be explained by a few factors: uneven access to vaccines, and the large variation in fiscal support packages between AEs and EMs

RHS
 The pandemic has also worsened within-country inequality across advanced economies. While earnings inequality has worsened, fiscal policy has largely been effective in mitigating these impacts. However, the disproportionate impacts of covid on women, young people and ethnic minorities poses a risk of persistent unemployment and scarring. As you can see on the chart on the right, in the US ethnic minorities see higher employment losses than white counterparts. Some ethnic minorities take longer to re-enter employment and are more likely to leave the workforce when becoming redundant; as women carry out a disproportionate amount of unpaid care work, their ability to re-enter the labour market is limited making their unemployment is more persistent. Young people are particularly exposed to scarring because they lose the opportunity to build up skills. We think the experience in the euro area is likely to be similar – but they don't collect data on ethnic minorities.

EMs also face risks from policy spillovers and inflation



LHS

Another risk facing EMs is 'policy spillover' risks from the US, which would be exacerbated by an uneven global recovery. Specifically, if rising US inflation causes US monetary tightening to begin before most EMs recoveries have materialised, this could lead to a 'taper tantrum'— significant capital outflows from EMs and volatility in financial markets, causing a number of risks for EMs, reducing global financial stability and placing pressure on the global financial safety net. This could weigh on global growth, through weighing on EM's growth prospects.

This is highlighted in the chart by recent capital flow patterns, with EM securities in February 2021 attracting the lowest levels of capital flows since August 2020; and equity inflows for non-China EMs hit particularly hard.

A key reason for this downturn in EM inflows has been awakening fears of a reflationary cycle in the US, which increased downside risks on EM investments.

While market patterns have reversed since, with higher EM inflows in March, this issue could raise its head again.

RHS

Another risk to EMs is recently rising commodities prices (due to a mix of factors*) which could add to inflationary pressures, especially if China and US race ahead, with commodity-importing EMs at higher risk. [*increased consumer demand for some metals; supply chain disruption driving up agricultural commodities prices; markets speculation]

Sustained rises would likely affect these EMs: through different channels:

- EMs generally have weaker policy environments and less monetary credibility.
- EMs' inflation basket is typically more weighted towards commodity-intensive goods.

If this forced EMs to tighten rates, it could slow recoveries, weighing on global growth. But commodity-exporting EMs could benefit.

Commodity prices and inflationary pressures

In February Brent crude oil prices hit pre-pandemic levels above \$60, Copper hit a 10-year high, and higher grain prices have led global food prices to their highest in more than six years.

Rising commodities prices could add to inflationary pressures, especially if China and US race ahead, with commodity-importing EMs at higher risk.

Sustained rises would likely affect EM inflation through different channels:

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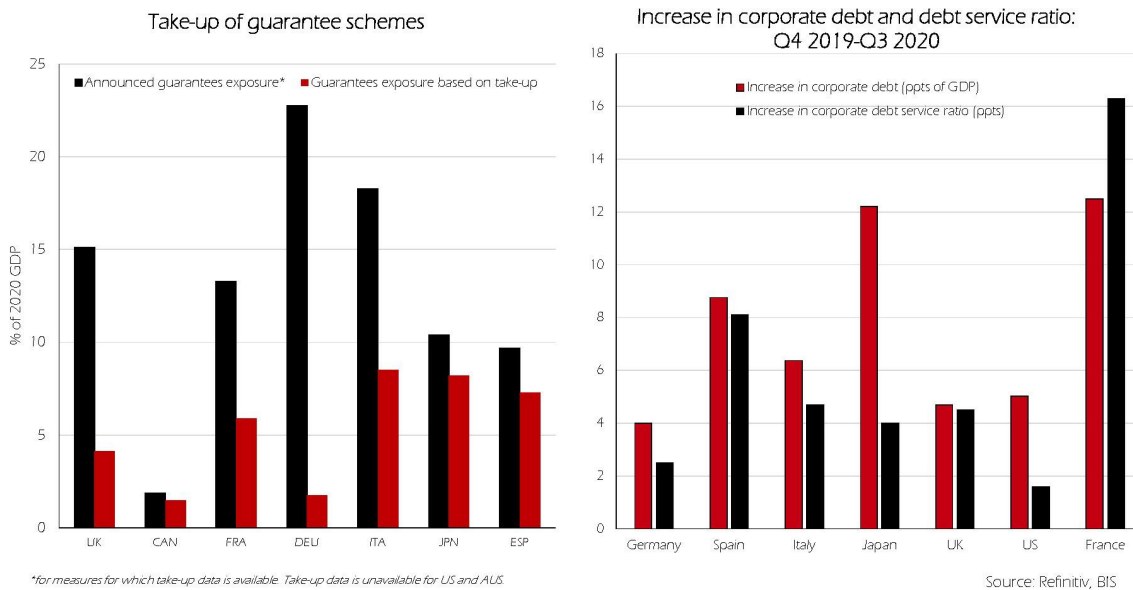
EMs' inflation basket is typically more weighted towards commodity-intensive goods.

If this forced inflation-targeting EM central banks to tighten rates, it could slow recoveries and thus weigh on global growth. But commodity-exporting EMs could benefit from currency appreciation and downward pressure on inflation via cheaper imports.

IMF (2012) supports this: commodities exporters experienced stronger macro performance during the 1970s and 2000s commodity booms.

Oil price rises could also contribute to higher UK inflation. Typically, we'd also expect a 10% increase in oil prices to push pump prices up by 3%, adding around 0.1ppts on to CPI. Oil price shocks feed through indirectly to other parts of the inflation basket, e.g. manufacturing and transport, but passthrough takes longer and depends on additional factors such as firm hedging strategies.

Guarantee schemes have helped to support firms, but increased corporate debt could be a problem



LHS:
As shown in this chart on the left, government guarantee schemes have seen high levels of take-up in most countries except Germany. These guarantee schemes have helped to support lending to nonfinancial firms, helping firms cope with liquidity pressures as earnings collapsed during the pandemic.

RHS
However, this has been accompanied by a rise in aggregate corporate debt levels, as the chart on the RHS shows. Corporate debt levels have increased by an average of 7.7 percentage points in G7 countries over the course of the pandemic, and debt service ratios (share of companies' income used to service debt) have also risen by an average of 6 percentage points (pp) in advanced economies. This could have implications for economic growth or financial stability. Firms that have survived the pandemic by taking on more debt may be slower to invest or recruit once the recovery takes hold; or may struggle to service their debt as support is withdrawn.