Global Monthly

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Will headwinds throw the recovery off course?

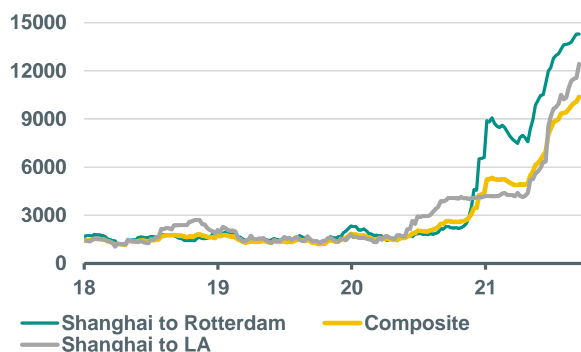
- **The global recovery has lost momentum, and is facing three key headwinds: 1) the spread of the Delta variant, 2) persistent supply chain bottlenecks, and 3) the unwind of government support**
- **Bottlenecks are now likely to persist well into 2022, capping growth in the manufacturing sector**
- **However, this is also likely to extend the recovery. And despite the headwinds, we expect growth to remain above trend, with a services recovery that still has a long way to go**
- **Regional updates: in *the eurozone*, we look at coalition formation after the German election, and in *the Netherlands*, the *Prinsjesdag* budget was light on policy changes from the caretaker government**
- **In *the US*, upside risks to inflation remain, while the Fed moved a step closer to tapering**
- **We lowered our growth forecasts for *China*, but expect Beijing to contain the Evergrande fallout**
- **In this month's new *Spotlight*, we explain what China's regulatory crackdown means for the outlook**

Global View: Headwinds abound – but growth should remain above trend

The global recovery from the pandemic is entering a new, and likely more turbulent phase. The 'low hanging fruit' of the reopening rebound is now behind us, and while there is still much room for economies to recover, the headwinds have become more pronounced. The more immediate of these is the spread of the Delta variant. This has driven a loss of momentum in the US services recovery, and dampened consumer sentiment. In China, the reimposition of restrictions in pandemic hotspots has led to a likely stalling in economic growth in Q3, and we have downgraded our growth forecast for 2021 on the back of this. Another headwind for the global economy is the supply-side bottlenecks linked to the reopening, which have proven more stubbornly persistent than initially thought. We expect these bottlenecks to continue constraining activity well into 2022. The third and final key headwind to watch is the unwind of government support measures. September is a crucial month for this in the US, where unemployment benefit top-ups will expire, and in the Netherlands and the UK, where wage subsidy schemes will formally end. For most eurozone countries, this headwind is rather less pronounced, with support continuing to unwind only gradually. What does all of this mean for the outlook going forward?

Bottlenecks are proving more persistent

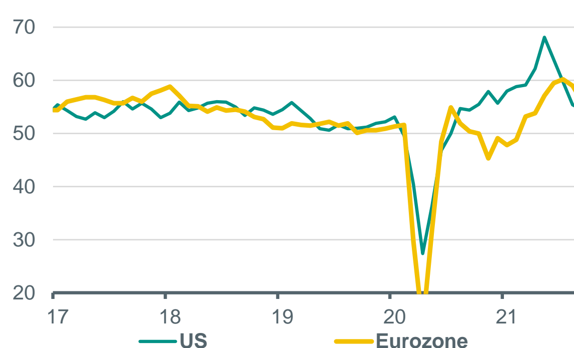
Freight rates, USD per 40ft container



Source: Bloomberg, ABN AMRO Group Economics

Is the loss of momentum something to worry about?

Composite PMIs, >50 = expansion in activity



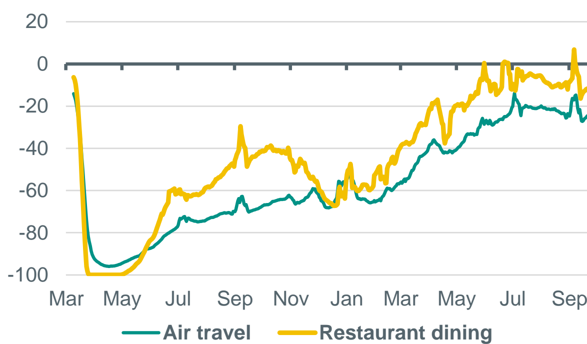
Source: Refinitiv, ABN AMRO Group Economics

Damage from Delta: Visible in the US, significant in China, but limited in the eurozone

Although the Delta coronavirus variant hit European shores sooner, the wave of infections – and the burden on hospitals – has been much bigger in the US. Correspondingly, so has the economic impact. While there have been no new restrictions on activity, consumers have themselves become more cautious. This is most visible in the collapse in consumer confidence since August, with the Michigan survey falling to a near 10-year low. We also see a loss of momentum in the services recovery in the US, with the most pandemic-sensitive sectors such as air travel and restaurant dining stuck stubbornly below pre-pandemic levels. This contrasts with the eurozone, where a more cautious reopening combined with higher vaccination rates has helped to contain the spread of Delta, and where the services recovery appears to have continued apace – Google mobility data shows visits to retail & recreation establishments overtaking those in the US, where such visits remain below pre-pandemic levels. Moreover, consumer confidence in the eurozone has remained at historically high levels.

US services recovery has stalled

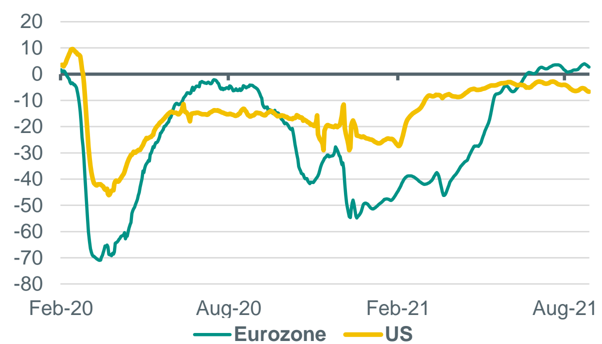
% vs pre-pandemic level



Source: Refinitiv, ABN AMRO Group Economics

Eurozone mobility metrics now higher than in the US

Visits to retail & recreation establishments, % vs pre-pandemic level

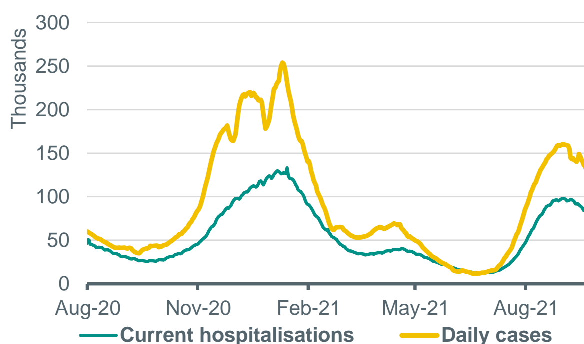


Source: Refinitiv, ABN AMRO Group Economics

In China, the government's hardline approach towards even minor Delta outbreaks has significantly dented the recovery, with regional lockdowns and travel restrictions during the busy summer season. This was evident in the August activity data, which showed a sharp fall in annual retail sales growth, driven by services categories such as eating out. We now expect hardly any quarterly growth in Q3, and although a rebound is likely in Q4, this has led us to cut our 2021 growth forecast to 8.3%, from 9.0%.

US Delta wave looks to have peaked

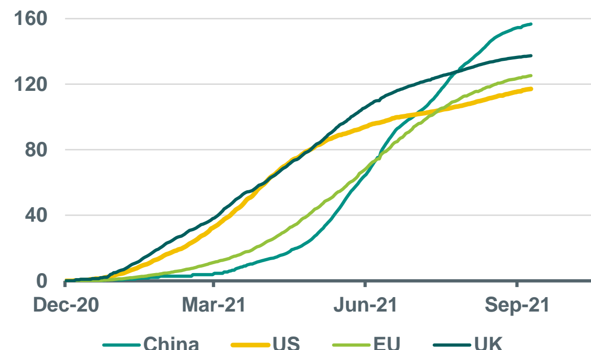
Covid-19 cases and hospitalisations



Source: Refinitiv, ABN AMRO Group Economics

China's vaccination drive - approaching herd immunity

Single vaccine doses administered per 100 people



Source: Bloomberg, ABN AMRO Group Economics

Could a winter resurgence derail things?

What can we expect going forward? We think we have likely turned the corner with Delta, and that the impact in the US and China should fade over the coming months. First, both case numbers and hospitalisations have peaked in the US, and some epidemiologists have suggested that the summer wave has likely brought forward a large number of cases that would have happened over the winter; by November, models suggest case numbers will be back at early summer levels. Second,

vaccination rates continue to rise in both the US and China, with China expected to reach herd immunity by year end, while in the US a combination of vaccinations and natural immunity should blunt any winter wave. In the eurozone, while a winter wave among the unvaccinated remains a risk, stricter rules banning entry to restaurants and major events to the unvaccinated (unless they pay for frequent covid tests) are likely to maintain pressure on the vaccine hold-outs to get jabbed. As such, we do not view another pandemic wave as a serious risk to the eurozone outlook.

Bottlenecks are dampening growth from multiple angles

A more persistent risk to the outlook, in our view, instead comes from the supply chain bottlenecks, including the semiconductor shortage and the disruptions to shipping. Aside from the upward pressure on inflation – a topic we covered in our August Monthly – these bottlenecks have also put a dampener on growth, via a number of channels. First, the global industrial upswing has lost momentum, evident in both hard (industrial production) and soft (PMIs) indicators. This was confirmed in the September flash PMIs for both the eurozone and the US, which – although still elevated – pointed to a further slowdown in manufacturing. If we strip out the effect of the record lengthening in delivery times from these, which has an upward effect on the headline PMI, the slowdown has been even more marked. Bottlenecks also seem to have hampered investment, which was surprisingly weak in the US and some eurozone economies in Q2. It goes without saying that all of this is not for lack of demand: the sub-indices for new orders remain elevated across regions, and on the consumer side, demand for goods in the US remains well above trend, while in the eurozone demand has recovered back to trend.

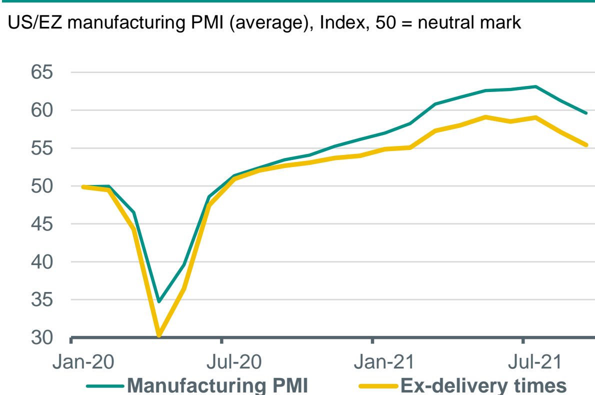
Global manufacturing has lost momentum

% 3m/3m

Source: Refinitiv, CPB, ABN AMRO Group Economics

PMIs are lower still if you exclude delivery times

US/EZ manufacturing PMI (average), Index, 50 = neutral mark



Source: Bloomberg, Refinitiv, ABN AMRO Group Economics

Germany particularly hard hit by auto sector disruption

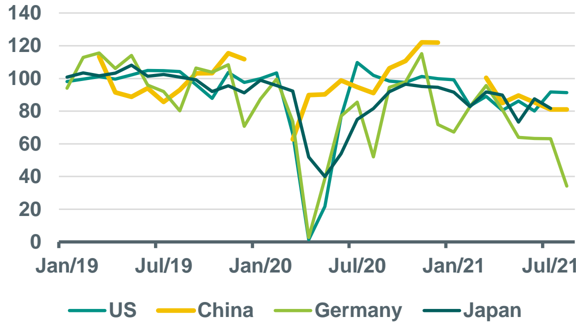
The semiconductor shortage has had a particularly marked effect on the car industry, with automakers across the globe implementing production stops. For this sector, growth has not merely slowed, but we are seeing sharp contractions in output. For instance, in Germany – which has been especially hard hit – car production is down by more than 60% from its peak early this year. Given the size of the sector in Germany (1/5 of industrial production, and around 5% of GDP), the drop in car output has been enough to pull total industrial production lower (-0.7% 3m/3m as of July), despite every other sector continuing to expand. In contrast, production at the eurozone aggregate level – of which cars has a much smaller share – has been more or less stable, but the collapse in car production has clearly taken the wind out of the manufacturing sector's sails. In the US, car production has also fallen, although not by nearly the same degree. Given that it also has a much smaller share of overall production (at around 4%), the weakness in the US has not been enough to prevent continued expansion in manufacturing, which as of August was up 1.5% 3m/3m.

These supply chain bottlenecks have proven more persistent than initially expected, and we now foresee problems continuing well into next year. Indeed, lead times for semiconductors are reported to have risen further, reaching 21 weeks last month (compared to an average of around 12 weeks in the pre-pandemic year of 2019). The shortage in semiconductors has been exacerbated by plant closures in Malaysia and Vietnam, which have been under strict lockdowns linked to the Delta variant spread. With regards shipping – and the seven-fold rise in container freight tariffs – several global shipping lines have indicated recently that they will stop increasing spot freight rates. With that said, it is difficult to foresee rates falling back to pre-pandemic levels any time soon, with the industry still struggling to contain the impact of port

congestion and temporary closures linked to virus outbreaks (notably in China/Asia). Ultimately, these bottlenecks will of course ease. When this does happen, it is likely to provide a significant tailwind to industries that have struggled to keep up with demand, and we think this could even elongate the recovery. In the meantime, however, global manufacturing growth will remain constrained.

Car production under pressure

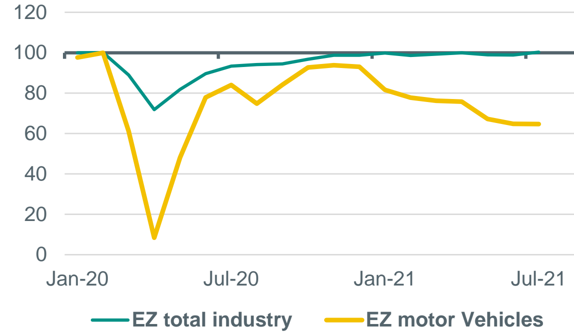
Volume index, average 2019 = 100



Source: Refinitiv, ABN AMRO Group Economics

EZ total industry stable despite drop in car production

Index, pre-pandemic = 100

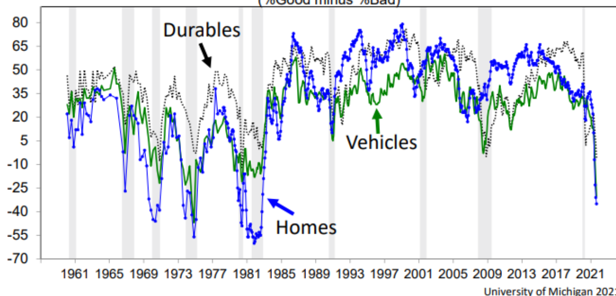


Source: Bloomberg, Refinitiv, ABN AMRO Group Economics

Early signs that inflation could start to hit consumer demand

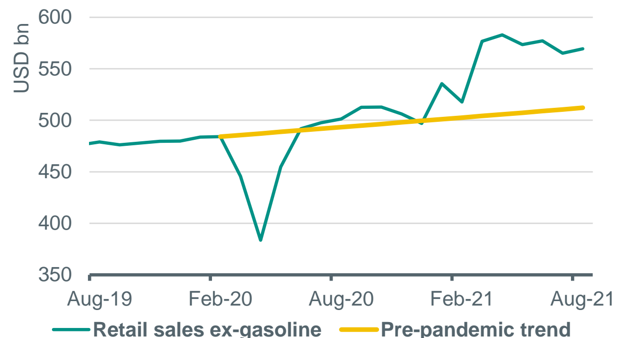
An easing in manufacturing bottlenecks cannot come soon enough for consumers, who – particularly in the US – have had a seemingly insatiable demand for goods. Indeed, despite goods consumption being well above trend for more than a year now, retail sales unexpectedly rose again in August. However, there are some early signs that the rapid increase in goods inflation – particularly in autos – will trigger a long-expected correction in retail sales. While a big driver of the decline in US consumer sentiment has been the spread of the Delta variant, a striking feature of the September Michigan survey was the collapse in measures relating to durable goods and other 'big ticket' purchases. In this part of the survey, consumers are asked whether they think it is a good time to buy household durables, cars, and houses. All three measures fell to levels not seen since 1980, and according to the survey authors, the declines were due to 'spontaneous references to high prices'. Given the excess goods consumption we have seen over the past year, some declines would be a welcome and healthy development for the economy, and this is a key pillar of our base case for the US. There is a risk, however, that such a decline gets out of hand and overshoots, leaving manufacturers now struggling to fulfil demand with potentially the opposite problem further down the line – an inventory overhang. In the eurozone, this risk is much lower, but still significant. Although core inflation has been much more benign, the run up in energy prices – which this month led us to substantially raise our forecasts – is leading to falls in real wages in some economies. While the build-up in excess savings during the pandemic offers some buffer for consumers for the foreseeable future, we see a significant risk that this could cap consumption growth later next year and into 2023. This is one reason for our below consensus growth forecast for next year (3.8% vs 4.3%).

Weak sentiment in US increasingly driven by inflation



Source: University of Michigan

We expect a pullback in US goods consumption



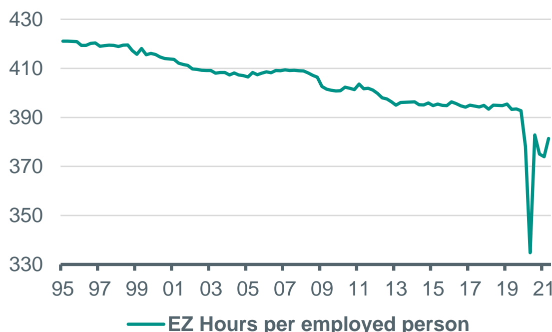
Source: Bloomberg, Refinitiv, ABN AMRO Group Economics

Unwind of government support: Could a headwind become a tailwind?

If all of these headwinds were not enough, there is also the unwind of government support measures to contend with. September is a crucial month in this regard; in the US, generous unemployment benefit top-ups expire at the federal level (they had already expired in around half of US states), while in the Netherlands and the UK, the wage subsidy schemes that have helped millions of workers retain their jobs through the pandemic will formally end. As a base case, we do not expect a 'cliff edge' type impact from the end of these support measures – with a sudden surge in bankruptcies and unemployment – to result. Economies have for the most part fully reopened, with only very specific sectors – such as airlines, for instance – still facing significant revenue shortfalls. In Germany, the short-time work (STW) scheme in its current shape will not end before the end of this year, but companies have already reduced their use of the scheme significantly (the share of employees in STW has declined from around 8.5% in February to just 2% in August). In France, financial support for companies with employees in STW gradually become less favourable (and in line with the changes in activity) from June onwards. The share of employees in STW in France dropped from 15% in April to 3% in July.

We expect a temporary hit to incomes in the US from the expiration of benefit top-ups, of which around 10mn were still in receipt as of early September. In the eurozone, we also expect a rise in unemployment over the coming months, as businesses make painful adjustments to the new post-pandemic normal. Here, many are still working less than their usual hours, suggesting more slack than headline unemployment indicates. However, the rise in labour supply in the US and many eurozone countries will be met with very strong demand for labour, with job vacancies surging in recent months. Indeed, one of the main supply-side bottlenecks we have written about in the past has been in the labour market, and the early end to unemployment benefit top-ups in many US states was precisely in response to complaints from businesses that support was preventing people from returning to the labour market, leading to labour shortages. As such, the gradual pullback of government support could well prove to be a tailwind that helps economies along the recovery and adjustment path.

Eurozone: Hours per person remains depressed



Source: Refinitiv, ABN AMRO Group Economics

US: Labour supply increase will meet strong demand

Millions

Source: Refinitiv, ABN AMRO Group Economics

Conclusion: Headwinds are significant, but unlikely to derail the global recovery

All told, the outlook for the global economy remains strong. To some extent, the slowing we are seeing now was inevitable following the initial reopening bounce, and consistent with our base case. The combination of headwinds we have outlined here are putting an additional dampener on growth, while posing downside risks to the outlook. Despite this, we continue to expect above trend growth to continue well into 2022, and after the current soft patch we expect the recovery to regain some momentum next year. While goods consumption is due a healthy correction, the services recovery has a long way to go before consumption returns to the pre-pandemic trend. The passing of the Delta wave is likely to give the services sector – which **makes up the bulk of private consumption** – a renewed boost. Growth will also be helped by higher government investment, with Biden's infrastructure spending plans in the US likely to start kicking in, and with the Recovery Fund in the eurozone starting to disburse to member states. At the same time, while supply bottlenecks have proven more persistent than expected, they are still likely to ease to some extent in 2022, and this should give a new tailwind to the recovery, given the likely significant pent-up investment demand. Finally, the normalisation of labour markets should also aid the recovery, and by the end of the year many economies should be back near pre-pandemic levels of employment. In the near term, however, the global economy could be in for a bumpy ride. (Bill Diviney, Aline Schuiling, Arjen van Dijkhuizen)

Eurozone: Political changes after the pandemic… Germany first?

Aline Schuiling – Senior Economist | aline.schuiling@nl.abnamro.com

- **High vaccination rates have allowed a further unwinding of social distancing and lockdown measures in the eurozone**
- **The economy is shaking off the impact of the pandemic, and GDP growth was higher than expected in Q2. The outlook for H2 2021 and 2022 is one of ongoing robust, above trend growth**
- **Meanwhile, the pandemic could also have had an impact on the popularity of policymakers, resulting in changes in the political landscape of various eurozone member states. The first test was Germany, where general elections were held on 26 September**

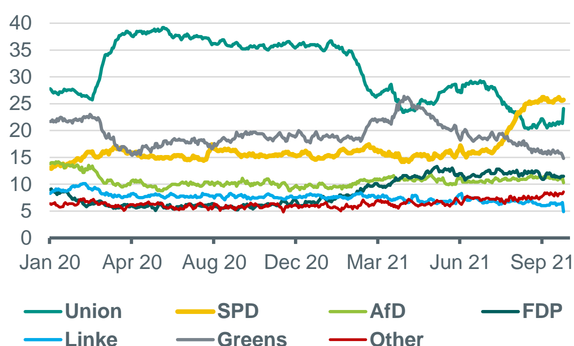
The eurozone economy has bounced back sharply around the start of summer. The first estimate for GDP growth in Q2 turned out higher than expected and, subsequently, was revised even higher (to 2.2%, up from a first estimate of 2.0%). We expect ongoing robust growth in the coming quarters, as social distancing measures are unwound further and final domestic demand is expected to make up most of the losses of the pandemic. This should result in strong growth in H2 2021 (of between 2.5 and 3% in total) and bring GDP back to its pre-pandemic level in the final quarter of this year. In 2022, growth is expected to remain well above trend, albeit quarterly growth will slow compared to 2021 Q2-Q4.

Meanwhile, the pandemic and how policy makers have reacted to it, has likely also had an impact on the political climate in the eurozone. The first test of this was on 26 September, when Germany elected its new Bundestag. The results of the election show that the centre-left SPD became the largest party (25.7% of the votes) and that its leader Olaf Scholz will probably succeed Angela Merkel. Still, it was a close call and the gap with the conservative CDU/CSU (24.1%) was narrow. Compared to the results of the previous election, besides the SPD, the Greens and FDP were the parties that won the most, while the CDU/CSU (*the Union*) and the left wing Die Linke lost the most.

Although continuation of the Grand coalition between SPD and the Union would in theory be feasible, both parties have ruled this out. Therefore the next coalition will have to include three parties. This will either be dominated by either the centre-left SPD and Greens (who share many point in common in their political programs – especially with regard to labour and social affairs) or the conservative Union and liberal FDP (also with a lot of overlap in their plans). As the SPD and Greens together gained more than 100 seats in the Bundestag, and also would have about 35 seats more than the combination Union-FDP (that lost almost 40 seats), we think the most likely outcome will be a so-called 'Traffic light' coalition of SPD, the Greens and the FDP. However, negotiations will be tough as the party programmes of the SPD/Greens and FDP vary a lot on a number of crucial issues. For more on the German election and the most likely policy changes after the election, please read our research note here.

Polls and outcome German election

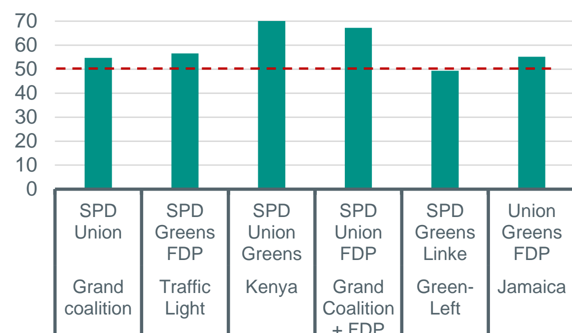
% of votes, 5-poll moving average



Source: Polling organisations, ABN AMRO Group Economics

A three-party coalition on the cards

% of seats, after redistribution of votes for parties that miss the 5%-hurdle



Source: Der Bundeswahlleiter, ABN AMRO Group Economics

The Netherlands: Sober 2022 spending plans

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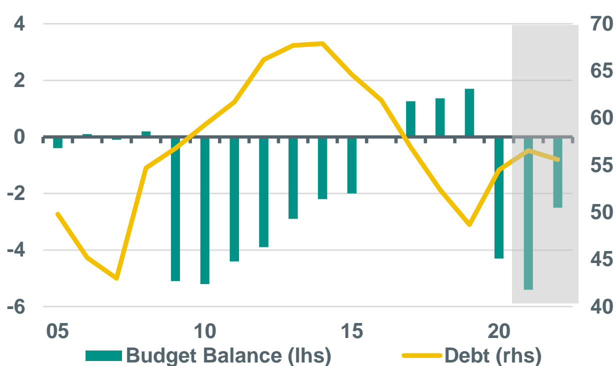
- **Dutch caretaker government presented a policy-light budget**
- **Phasing out of Covid support helps government finances take a favourable turn**
- **Increased purchasing power, savings and upbeat consumer sentiment to lift consumption in 2022**

The parliamentary year officially opened on Tuesday with the presentation of the government's 2022 spending plans, at 'Prinsjesdag'. Due to the caretaker status of the current government, it is customary to have a policy-light budget. Most of the announced policy measures and budgets were already in place, or are plans that all parties in parliament unanimously agree upon. An extra €1bn has been allocated to building new housing. This is very marginal, as it is spread over 10 years. In this year's spending plan, expenditure was also reserved for building new homes and the amount was oversubscribed in a couple of months already. This measure is therefore unlikely to solve long-standing problems in the Dutch housing market. €6.8bn will go to the reduction of CO2 emissions, in line with the Urgenda court ruling. That said, other spending plans for combating climate change are too politically sensitive and therefore absent in this budget. The €2bn that was originally reserved for job related investment at companies (Baangerelateerde Investeringskorting, BIK) will be spent on combating organised crime and investment in the high-tech industry. Significant policy changes, for instance in important areas of taxation, cutting nitrogen emissions and the labour market, are kept for the formation process and the resulting coalition agreement. The formation process has ground to a halt over worsening relations between the main parties, and is in need of a breakthrough. The likelihood of new elections has increased, especially in light of recent Eenvandaag polls that showed 6 out of 10 people would rather see new elections than the continuation of the current caretaker government.

According to current estimates, the damage to government finances in the Netherlands will be more moderate than in most other big eurozone countries. Indeed, the Netherlands will be the only large eurozone country (with a share in eurozone GDP larger than 1%) where the government debt ratio has remained below the 60% limit in 2021.

Government finances take a favourable turn

% GDP, forecast in gray



Source: ABN AMRO, CBS

Inflation is catching up with wage agreements

Year-on-year % change

Source: ABN AMRO, CBS

As has become customary on Prinsjesdag, the purchasing power forecasts were also presented by the CPB. In 2020 and 2021, the purchasing power of households improved significantly (2.5% and 0.8% respectively) due to the rise of collectively agreed wages, mostly settled before the onset of the pandemic. Moreover, the government contributed positively through changes in income tax, while inflation remained relatively low. In 2022, purchasing power looks to remain stagnant. Although employees see their collectively agreed wages rise by an average of around 2%, inflation is also set to remain high (our forecast for 2022: 1.6%). On top of that, there are a few changes that may contribute negatively to purchasing power, including a reduction of the tax-free deductibles of the self-employed and an increase in the healthcare premium. That said, dynamic purchasing power – which includes individual changes to income – is set to rise, as shortages in the labour market raise starting salaries and encourage promotions. Overall, in combination with the high savings rate and increasing consumer sentiment, we expect this to contribute positively to domestic spending (our forecast for 2022: 4.7%).

US: Inflation cools, but risks remain significant

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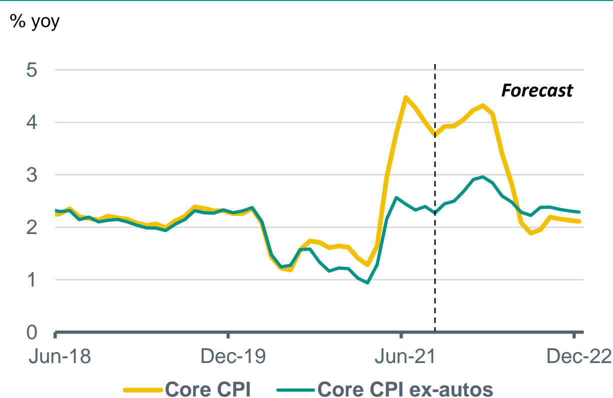
- **Inflation continues to be the dominant macro theme in the US**
- **Though the August CPI report showed a significant cooling in price growth, risks remain**
- **The Fed signalled its first major step back from easy policy. Rate hikes are still a way off though**

Inflation surprised to the downside in August, for the second month in a row, with the core CPI rising just 0.1% m/m – the weakest print since February. The report was consistent with our view that inflation has peaked in the US, and as we have previously flagged, the main driver was a fall in used car prices. At the same time, there was an unexpected cooling in services inflation, driven by declines in airfares and hotel room rates – likely due to the levelling off in demand in recent months, as the spread of the Delta variant led to increased consumer caution (see this month's Global View). We think we are past the peak in US core inflation, both on a monthly and an annual basis. However, annual inflation will remain elevated over the coming months given the low base of last year, and monthly inflation is unlikely to stay at the current subdued level for very long, for three reasons. First, although used car prices are now a drag on inflation, the decline in wholesale prices has been less than we anticipated given the drop-off in demand we have seen – likely due to the continued manufacturing bottlenecks for new cars, which have led to renewed plant closures among some auto makers. Second, we do not expect weak services inflation to last, given that we appear to be past the worst of the Delta wave of cases and hospitalisations. Third, the record level of job vacancies is likely to mean further strong gains in the labour market, and this should drive a firming in housing rents – by far the biggest component of the core CPI.

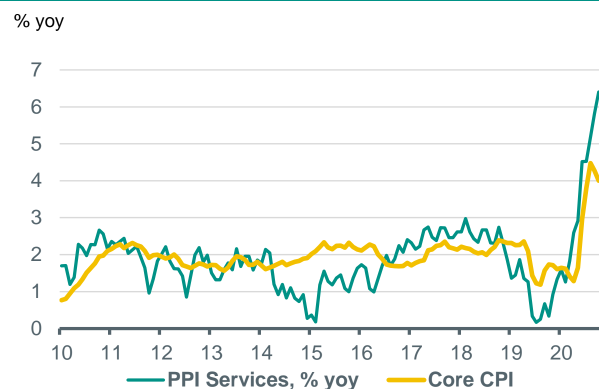
At the same time, the risks to our inflation forecast remain tilted to the upside, with supply-side bottlenecks easing only modestly so far, and producer price inflation yet to have peaked (see chart below). Taken together, we see scope for monthly inflation picking up again in the coming months, although we do not expect it to get anywhere close to the near-1% monthly gains we saw a few months ago. For annual inflation, this is likely to mean a significant drop-off from mid-2022 onwards to nearer 2% from the current 4% readings, as base effects ease.

Inflation to pick up again, before falling back



Source: Refinitiv, ABN AMRO Group Economics

Pipeline pressures remain a concern



Source: Refinitiv, ABN AMRO Group Economics

Fed signals pullback from easy policy

The Fed sent a strong signal with its September policy statement that a formal announcement of a tapering of asset purchases is now imminent. Our base case is that a decision will come in November, with the first reduction in purchases starting in December, and the process taking around 6 months. One risk to this view is whether a sufficiently strong pace of payrolls growth continues over the coming months, and Chair Powell was questioned on this in the press conference, particularly in light of the weak August print. If we get a weak or even lukewarm September payrolls (say, a 200k jobs gain), the Fed may opt to delay the decision until the December meeting. With regards rate hikes, in the press conference Powell was once again keen to stress that the timing of tapering had little bearing on rates lift-off. Our base case continues to be that rate hikes start in late 2023, consistent with our view that inflation will ease rapidly next year. We are currently reviewing our base case for the Fed ahead of publication of our 2023 growth and inflation forecasts. See our Fed Watch for more.

China: What's in a name?

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- **We downgraded our 2021 growth forecast to 8.3% (from 9.0%), with activity hit by strict Delta policy**
- **Limited passthrough from rising producer prices into CPI inflation leaves room for piecemeal easing**
- **Distress at property giant Evergrande adds to downside risks**

Over the summer, Beijing's zero tolerance approach towards new (Delta) outbreaks formed a clear headwind for economic activity, with services particularly affected. This was illustrated by a sharp drop in services PMIs and weak activity data for August. We now expect hardly any quarterly growth in Q3. We anticipate this to be followed by some payback and a pick-up in Q4, assuming further piecemeal support and with China reaching herd immunity by year-end (according to the National Health Commission). All in all, we have cut our 2021 growth forecast to 8.3% (from 9.0%), while leaving our 2022 growth forecast unchanged at 5.5%. That said, downside risks remain, in particular those stemming from the renewed tightening of restrictions in the event of future Delta outbreaks, and from the risks related to the situation at Evergrande (see below).

Limited passthrough from elevated PPI inflation into CPI inflation leaves room for piecemeal easing

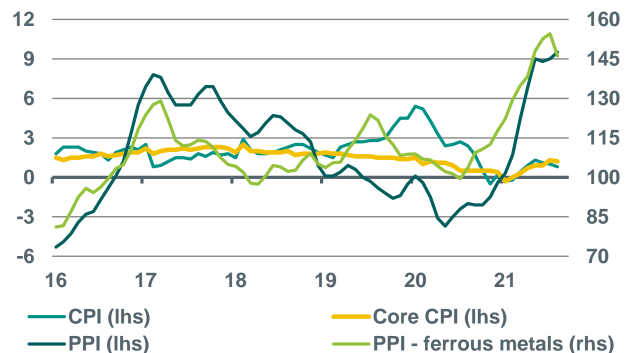
Producer price inflation (PPI) edged up a bit in August, reaching a 13-year high of 9.5% yoy (July: 9.0%). A closer look shows that price pressures are mainly concentrated in the commodity space and primary sectors. Meanwhile, both headline (CPI) and core inflation came down a bit in August, reaching 0.8% yoy (July: 1.0%) and 1.2% (July 1.3%), respectively. With the passthrough of pipeline pressures limited so far, we expect the shift to further piecemeal monetary and fiscal easing – that started with a 50bp RRR cut in July – to continue. We have pencilled in another 50bp RRR cut by the end of this year. We also expect ongoing PBoC actions to safeguard overall liquidity, and moderate fiscal easing.

Zero tolerance versus Delta hits (services) consumption

Indices, December 2019 = 100

Source: Refinitiv

No signs of passthrough from rising producer prices



Source: Bloomberg, Refinitiv

Distress at property giant Evergrande adds to downside risks

Distress at China's large real estate developer Evergrande, with ratings downgraded to very low levels, has fed systemic risk fears. This triggered market corrections in China and beyond, albeit with some relief following reports that the company is working on agreements with bondholders. While the problems will not be solved overnight, and this could cause further reverberations in global markets and add to growth risks, we assume that Beijing will seek a balance between reducing moral hazard and safeguarding financial stability. Preventing systemic risks has always been an important anchor for Beijing in managing risk events, and it would not seem very logical to steer this case purely from the perspective of 'reducing moral hazard'. Although curtailing a big company with malpractice also seems to fit with Beijing's regulatory crackdown and its shift to *common prosperity*, punishing 'the Chinese middle class' (including home owners) does not. All in all, it looks likely we will see some form of 'mixed solution', with debt restructurings (to deal with the moral hazard issue) on the one hand, and intervention to limit systemic risks on the other. Beijing has the tools to interact and engineer a longer-term solution, both in financial terms but also in governance terms. Indeed, a similar mixed solution was found for the asset management company Huarong earlier this year, although that was a state owned company while Evergrande is a private firm.

Spotlight: China's regulatory crackdown

Arjen van Dijkhuizen – Senior Economist | arjen.van.dijkhuizen@nl.abnamro.com

- **China's regulatory crackdown has taken investors by surprise…**
- **…but is part of a strategic plan and fits with Beijing's shift to 'common prosperity'**
- **No general attack on 'tech': high-tech manufacturing is still Beijing's favourite**

China's regulatory crackdown has taken investors by surprise…

Over the past year, Beijing started a regulatory crackdown on internet-related companies, triggering quite some market volatility. The crackdown started in November 2020, when the authorities presented new rules for fintech firms and halted a large IPO of Ant Group, the financial company affiliated with e-commerce giant Alibaba and owner of the online platform Alipay. Later on, Alibaba was fined and Ant Group was ordered to restructure, but it soon became clear that these actions were not just a personal vendetta against founder Jack Ma. In the course of 2021, Beijing broadened the crackdown to other fintech firms and online platforms (and bitcoin), but also to sectors such as online education and entertainment/gaming. For reasons of national security and data protection, the government also tightened rules for mergers and acquisitions and foreign IPOs, including banning *Variable Interest Entities* that Chinese firms often use to circumvent regulation.

…but is part of a strategic plan and fits with Beijing's shift to *common prosperity*

While the measures announced have occasionally taken investors by surprise due to a lack of clear communication, they are part of a broader strategic plan to improve regulation of the often underregulated internet-related parts of the economy. The sense of urgency for this has risen during the pandemic, as this highlighted the importance of internet services. Other concerns lay in the areas of national security and data protection, antitrust issues and improving competition. In its 14th Five-Year Plan covering 2021-25, the government launched the concept of *dual circulation*, stressing the importance of reducing China's dependence on foreign technology and critical imports (e.g. semiconductors) and improving the functioning of domestic markets. The crackdown goes hand in hand with other goals, such as reducing social inequality and supporting family values. China's Communist Party is putting more focus on traditional socialist goals and promoting *common prosperity*, a term first mentioned by Deng Xiaoping in the 1980s. Recently, president Xi Jinping pledged to 'reasonably adjust excessively high incomes, and encourage high-income groups and companies to give back more to society'.

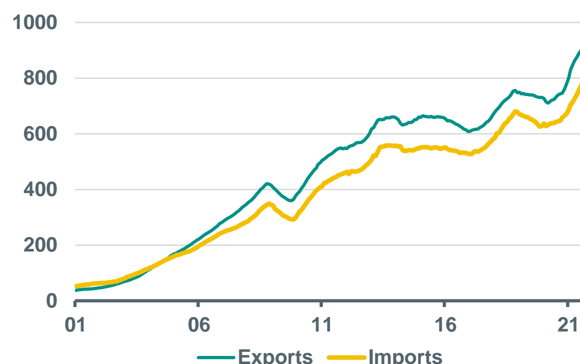
Regulatory crackdown has impacted equity prices

Stock price, indices, 29 Oct 2020 = 100

Source: Bloomberg, ABN AMRO Group Economics

High-tech manufacturing key driver of Chinese growth

Exports/imports of high-tech goods, USD bn, 12 months rolling sum



Source: Refinitiv, ABN AMRO Group Economics

No general attack on 'tech': high-tech manufacturing is still Beijing's favourite

We expect the regulatory campaign to continue, but investors will likely get used to this process and communication from Beijing should improve. The campaign will affect not only internet-related sectors, but also other sectors: particularly consumer services and public services such as education, healthcare, media and entertainment. The sector least likely to be affected by the regulatory campaign is high-tech manufacturing, the sector which receives the most government support. In our view, this regulatory crackdown is not so much a "general attack on tech," but rather an attempt by the Chinese leadership to shift resources to high-tech manufacturing which it sees as the key driver of China's technological advance.

Key views on a page

The global recovery has lost momentum, and is facing three key headwinds: 1) the spread of the Delta variant, 2) persistent supply chain bottlenecks, and 3) the unwind of government support. Bottlenecks are now likely to persist into 2022, capping growth in the manufacturing sector. However, this is also likely to elongate the industrial recovery, and despite the headwinds, we expect growth to remain above trend over the coming year. The services recovery still has a long way to go, and this recovery will be aided next year by the normalisation in labour markets, a pickup in government investment, and some easing in supply side bottlenecks. Despite the cautious withdrawal of pandemic support measures – with the Fed about to begin tapering its asset purchases, and wage subsidy schemes gradually wound down – both monetary and fiscal authorities will maintain a broadly supportive stance for growth.

Macro	Central Banks & Markets
Eurozone – The economy is shaking off the impact of the pandemic. With vaccination rates high, social distancing measures are being unwound further. GDP growth in Q2 was revised higher to 2.2% qoq (up from a first estimate of 2.0%). We expect ongoing robust growth during the rest of the year and in 2022 albeit at a more moderate quarterly pace than in 2021Q2. GDP will return to its pre-pandemic level around the end of the year. Inflation has jumped to 3% in August and is expected to rise further in the final months of the year, on the back of higher household energy prices (gas and electricity), but is expected to drop sharply lower again next year. Underlying (core) inflation will remain subdued. Labour market slack is abundant and wage growth has slowed already.	**ECB** – The ECB has published its Strategy Review. It has raised its inflation target to 2% from 'below, but close to, 2%', previously. The commitment to the target is symmetric, with negative and positive deviations from this target considered to be equally undesirable. Subsequently, in its July meeting, the Governing Council strengthened its forward guidance on interest rates. The new guidance states that the ECB 'expects the key interest rates to remain at their present or lower levels until it sees inflation reaching two percent *well ahead of* the end of its projection horizon'. This may also imply a transitory period in which inflation is moderately above target. All in all, we think that the ECB could keep policy rates unchanged through 2024.
Netherlands – The Dutch government presented its 2022 budget. Due to the caretaker status of the government the budget was policy-light. Significant policy changes for instance in the important areas of taxation, cutting nitrogen emissions and the labour market are kept for the formation process and the resulting coalition agreement. Q2 GDP was revised upward by a staggering 0.7 percentage points. Q2 qoq growth now stands at 3.8% (was 3.1%) and lifts our yoy growth forecast for 2021 to 4.4%, and for 2022 to 3%.	**Fed** – We expect an official taper announcement in November as a base case, with tapering to start in December. The tapering process should take around 6 months, with asset purchases ending entirely by mid-2022. The Fed has promised not to raise rates until maximum employment is achieved, and inflation is on course to moderately overshoot its 2% target for a time. Given these conditions, we expect the first rate hike by late 2023, although upside risks to inflation could bring this forward.
US – The outlook remains strong, with robust jobs growth, significant scope for further services sector growth, and large-scale infrastructure investment on the horizon. The spread of the Delta variant has blunted the services recovery, but the infection wave now looks to have peaked. We expect the services sector to resume its recovery, which should offset the looming correction in still-elevated goods consumption. Inflation has cooled, but risks remain tilted to the upside. We do not expect an overheating scenario that prompts aggressive Fed policy action, but continued elevated pipeline pressures have raised the risk of such a scenario.	**Bond yields** – Yields on US Treasuries have slipped back despite buoyant US data, suggesting the recovery is priced into the US Treasury market. Inflation expectations are around levels seen in 2018, when the US economy was already at full employment. Meanwhile, markets seem to have priced in a rate hike cycle with an eventual peak in the coming years close to the previous peak. However, the rate hike cycle is priced to start earlier than we expect. Rate hikes in the eurozone are unlikely in the coming years and therefore the 10y Bund yield will likely drift back towards the deposit rate.
China – Over the summer, Beijing's zero-tolerance covid-19 policy formed a clear headwind for economic activity, with services particularly affected. We now expect hardly any quarterly growth in Q3, followed by payback/a pick-up in Q4. With passthrough of high PPI-inflation to CPI-inflation limited, we expect Beijing to continue with piece-meal monetary and fiscal easing. We have downgraded our 2021 growth forecast to 8.3% (from 9.0%), while leaving our 2022 growth forecast unchanged at 5.5%. That said, downside risks remain (new outbreaks and tighter restrictions, potential spillovers from the Evergrande crisis).	**FX/EURUSD** – Momentum has shifted in favour of the US dollar again. The Fed was a bit more hawkish and this supported the dollar. Safe haven demand has also pushed the dollar higher. But the move has lost momentum and EUR/USD is back above 1.17 again. We keep our forecast for the end of this year at 1.18 an end of 2022 at 2022. This is mainly because we expect the Fed to be more hawkish than the ECB in the coming years.

Main economic/financial forecasts

GDP growth (%)	2019	2020e	2021e	2022e	3M interbank rate	16/09/2021	23/09/2021	+3M	2021e	2022e
United States	2.3	-3.4	6.2	4.1	United States	0.12	0.13	0.25	0.25	0.25
Eurozone	1.5	-6.5	4.9	3.7	Eurozone	-0.54	-0.54	-0.55	-0.55	-0.55
Japan	0.0	-4.7	2.6	2.5	Japan	-0.09	-0.07	-0.10	-0.10	-0.10
United Kingdom	1.4	-9.8	6.8	5.8	United Kingdom	0.07	0.07	0.10	0.10	0.10
China	6.0	2.3	8.3	5.5						
Netherlands	1.9	-3.8	4.4	3.0						
Inflation (%)	**2019**	**2020e**	**2021e**	**2022e**	**10Y interest rate**	**16/09/2021**	**23/09/2021**	**+3M**	**2021e**	**2022e**
United States	1.8	1.2	4.3	2.7	US Treasury	1.33	1.41	1.5	1.50	1.50
Eurozone	1.2	0.2	2.3	1.3	German Bund	-0.31	-0.26	-0.5	-0.50	-0.50
Japan	0.4	0.0	-0.2	0.6	Japanese gov. bonds	0.04	0.04	0.0	0.00	0.00
United Kingdom	1.8	0.9	1.1	2.0	UK gilts	0.82	0.91	0.7	0.70	0.80
China	2.9	2.5	1.0	2.5						
Netherlands	2.7	1.1	1.8	1.5						
Key policy rate	**23/09/2021**	**+3M**	**2021e**	**2022e**	**Currencies**	**16/09/2021**	**23/09/2021**	**+3M**	**2021e**	**2022e**
Federal Reserve	0.25	0.25	0.25	0.25	EUR/USD	1.18	1.17	1.18	1.18	1.15
European Central Bank	-0.50	-0.50	-0.50	-0.50	USD/JPY	109.7	110.3	110	110	118
Bank of Japan	-0.10	-0.10	-0.10	-0.10	GBP/USD	1.38	1.37	1.40	1.40	1.40
Bank of England	0.10	0.10	0.10	0.10	EUR/GBP	0.85	0.85	0.84	0.84	0.82
People's Bank of China	3.85	3.85	3.85	3.85	USD/CNY	6.46	6.46	6.40	6.40	6.20

Source: Refinitiv, ABN AMRO Group Economics.

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