

Vanguard economic and market update

Key points:

- Euro-area GDP growth forecast lowered to around 4% from around 5% for 2021.
- US economy still seen growing by 7% to 7.5% this year despite stronger first quarter.
- US Fed expected to start issuing guidance on balance-sheet unwinding in second half.
- UK economy seen recovering to its pre-pandemic level within a year.



Economic growth:

- High-frequency data suggest the economy in the **United States** gained considerable traction in the last half of March, a period that coincided with the start of stimulus payment disbursements under the \$1.9 trillion American Rescue Plan Act of 2021. The somewhat earlier-than-expected direct payments alongside a continued strong pace of vaccinations point to the US economy growing above the 5% we had previously anticipated in the first quarter. Such an increase would represent a carry-forward from the second quarter, so our view that the US economy will grow in a range of 7% to 7.5% for the full year hasn't changed. Real GDP increased at an annual rate of 4.3% in the fourth quarter, according to the US Bureau of Economic Analysis's final estimate. For all of 2020, real GDP declined by 3.5%.
- An increase in Covid-19 case numbers in France, Germany and Italy in March has led governments to tighten restrictions, including a third national lockdown in France. That development, alongside the continued slow rollout of vaccines compared with other developed markets, has led Vanguard to lower its forecast for 2021 GDP growth in the **euro area** to around 4% from around 5%. On a positive note, cases in France and Italy have since begun to decline. GDP fell by 0.7% in the fourth quarter of 2020 compared with the third quarter on a seasonally-adjusted basis, according to a second estimate by the European Union's statistical agency, while full-year GDP fell by 6.6% compared with 2019.
- GDP in the **United Kingdom** increased by 0.4% in February on a seasonally-adjusted basis, compared with a revised decline of 2.2% in January. A strong Covid-19 vaccination response, with a target to vaccinate all adults by July, supports the prospects for economic recovery. The bulk of restrictions on activity are set to be lifted by the end of this quarter, supporting our base case for full-year 2021 GDP growth of around 6%. We see UK GDP reaching its pre-pandemic level within a year. Supportive measures within the government's March budget announcement, including extensions to the furlough scheme, business support loans and directed tax cuts, give Vanguard confidence that scarring in the UK economy will be relatively limited.
- High-frequency data suggest that recent Covid-19 outbreaks and related restrictions in **China** weren't as disruptive as initially feared, with consumption indicators decreasing less than expected. The data support our assessment for full-year growth of around 9%, a level to which consensus estimates have recently risen closer. With outbreaks under control, we expect service activities to resume fully in the coming weeks. Vanguard continues to see quarterly growth slowing, but remaining positive, to around 1% in the first quarter, compared with fourth-quarter 2020 growth of 3%. Just about 10% of the population has been vaccinated, meaning China will need to considerably ramp up vaccine distribution to hit its target of 40% by June.

Note: These points represent the house view of the Investment Strategy Group's (ISG's) global economics team and other experts as at 14 April 2021.

For professional investors only (as defined under the MiFID II Directive) investing for their own account (including management companies (fund of funds) and professional clients investing on behalf of their discretionary clients). In Switzerland for professional investors only. Not to be distributed to the public.

- Greater optimism around vaccination efforts and pass-through effects of a strengthening US economy support our view that **emerging markets** in aggregate will grow by more than the 6% outlook we communicated at the end of 2020. We continue to see emerging Asia leading the way, with 2021 growth above 8%. The region has been largely successful in managing the pandemic, and its export-driven model is likely to prosper as global growth accelerates. We'd expect Latin America to trail, with 2021 growth of around 4% not making up for a contraction of 7.4% in 2020.



Monetary policy:

- The **US Federal Open Market Committee** voted on 17 March to leave the target range for its federal funds rate unchanged at 0%–0.25% and its bond-buying programme unchanged. Federal Reserve Chairman Jerome Powell has emphasised that the Fed would communicate potential changes to its \$120 billion-per-month bond-buying programme well in advance of any tapering of purchases. Powell on several occasions has said that the Fed wasn't going to even "talk about talking about" tapering. Given US economic strengthening and a quickening in the pace of vaccinations, however, Vanguard expects that in the second half of the year the Fed will start to issue guidance around how and when it might start the unwinding of its balance sheet. We continue to anticipate a lift-off for the Fed's interest-rate target only in the third quarter of 2023.
- The **European Central Bank** left its key rates intact at its 11 March policy meeting but signalled a "significantly higher pace" of asset purchases under its Pandemic Emergency Purchase Programme (PEPP). That accelerated pace doesn't yet appear to have materialised, but Vanguard believes the ECB remains poised to use the PEPP to keep a lid on real yields and ensure that financial conditions don't materially tighten. The bank said it would continue asset purchases under the PEPP until at least the end of March 2022, "and, in any case, at least until it judges that the coronavirus crisis phase is over".
- Given the encouraging progress of vaccine rollout in the United Kingdom and the economic outlook, we expect the **Bank of England** (BOE) to slow the pace of its asset purchases over the coming quarters and to continue such purchases only until the end of the year. We anticipate that the BOE will start lifting its bank rate from December 2022. The BOE maintained its bank rate at 0.1% at its 17 March Monetary Policy Committee meeting and left its bond purchase programme target unchanged at £875 billion.
- Vanguard expects China to gradually normalise fiscal and monetary policy over the course of 2021 as it continues to balance near-term growth



Inflation:

- and medium-term financial stability. On the fiscal side, we expect the government to aim to reduce its official fiscal deficit target from 3.6% to 3.2%, while on the monetary side, policymakers will aim to slow credit growth in line with nominal GDP. We don't, however, expect the **People's Bank of China** to increase its policy rate this year.
- Vanguard expects central banks in **emerging markets** broadly to seek stability in the face of fiscal expansion in the United States. Of the last 14 emerging-market central banks to review policy, 11 have left interest rates on hold while three – Russia, Brazil and Turkey – have increased rates, partly in response to their own domestic factors.
- The Consumer Price Index (CPI) in the **United States** rose by 0.6% in March on a seasonally-adjusted basis compared with February, the largest increase since August 2012, with higher gasoline prices accounting for nearly half the increase. Core CPI, which removes volatile food and energy prices, rose 0.3%. Compared with a year earlier, the broad price index rose 2.6%, while core prices were up by 1.6%. These numbers compare with the Federal Reserve's preferred inflation measure, the core Personal Consumption Expenditures (PCE) index. Core PCE rose 0.1% in February compared with January on a seasonally-adjusted basis, and by 1.4% compared with a year earlier, less than its increases in January. Vanguard expects core US inflation above 2% in the second quarter, given base effects, or comparisons to weak year-earlier numbers. We also expect some volatility on a sector-by-sector basis; some sectors could see temporary mismatches between supply and demand as consumers re-engage with the economy. But we believe these mismatches will be temporary and we expect that a continuation of the long-term structural trends that have kept inflation low for more than a decade will continue to limit price rises.
- Headline inflation rose by 1.3% in the **euro area** in March on an annual basis, up from 0.9% in February, according to a flash estimate from the European Union's statistical agency. The gains were driven almost exclusively by energy prices. Core inflation, which excludes volatile food and energy prices, was estimated to have risen by 0.9% – the weakest gain in three months. We expect headline inflation to surpass 2.0% in the second half of the year on continued gains in energy prices. We expect that supply chain bottlenecks in the manufacturing sector will also exert upward inflationary pressure. We foresee core inflation rising toward 1.5% as the pace of economic recovery increases in the second half of the year, but underlying price pressures remain subdued amid weak labour bargaining power and low inflation expectations.

- Headline inflation rose by 0.4% in February in the **United Kingdom** compared with a year earlier, down from a 0.7% rise in January. Vanguard expects both headline and core inflation to rise in the months ahead, toward the Bank of England's 2% target, as the effects of sharply lower energy prices and short-term tax cuts unwind, and as the economy strengthens.



Employment:

- The unemployment rate in the **United States** fell to 6.0% in March as 916,000 jobs were created in a broad-based recovery. We expect job gains to average more than 500,000 per month for the remainder of the year, with gains front-loaded in this quarter and the next, and the unemployment rate falling toward 5.0% by year's end. Nonetheless, by the end of 2023, we expect overall employment to be around 1.2 million lower than we had forecast before the pandemic.
- Unemployment in the **euro area** remained steady at 8.3% in February on a seasonally-adjusted basis compared with a revised reading of 8.3% in January. The unemployment rate has risen only modestly from 7.3% in February 2020, before the pandemic shock.
- The unemployment rate in the **United Kingdom** registered 5.0% in the three months ended in January, down slightly from 5.1% in the quarter ended in December 2020 but up by 1.1 percentage points compared with a year earlier. The economic inactivity rate, the percentage of the working-age population not employed or seeking employment, stands at 36.6% – its highest since September 2017, suggesting a growing number of potential workers discouraged by the pandemic-era jobs market or not in a position to take on work. Vanguard expects employment to be supported by the extension of the Coronavirus Job Retention Scheme until September as part of the UK's recently announced budget.



Asset class return outlooks:

- Vanguard's 10-year annualised outlooks for equity and fixed income returns are unchanged since the March 2021 economic and market update. The probabilistic return assumptions depend on market conditions at the time of the running of the Vanguard Capital Markets Model® (VCMM) and, as such, can change with each running over time.
- ISG updates these numbers quarterly. The projections below are based on the 31 December 2020 running of the VCMM. Projections based on the 31 March, 2021 running of the VCMM will be communicated through the May 2021 economic and market update.
- Our 10-year annualised nominal return projections are as follows. Please note that the figures are based on a 1-point range around the 50th percentile of the distribution of return outcomes for equities and a 0.5-point range around the 50th percentile for fixed income. Numbers in parentheses reflect median volatility.

	Median projected volatility (%)	Ten-year annualised nominal return projections
UK equities [†]	19.4	5.7–7.7%
Global equities ex-UK (unhedged) [†]	19.1	3.5–5.5%
UK aggregate bonds [†]	6.2	0.0–1.0%
Global bonds ex-UK (hedged) [†]	2.8	0.3–1.3%
Euro area equities*	25.3	4.1–6.1%
Global equities ex-euro area (unhedged)*	19.1	2.4–4.4%
Euro area aggregate bonds*	3.3	-0.3–0.7%
Global bonds ex-euro area*	1.7	-0.2–0.8%

Note: * return projections are calculated for euro investors. † return projections are calculated for British pound investors. Any projections should be regarded as hypothetical in nature and do not reflect or guarantee future results.

Important

The projections or other information generated by the Vanguard Capital Markets Model regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modelled asset class. Simulations are as of December 31, 2020. Results from the model may vary with each use and over time.

The VCMM projections are based on a statistical analysis of historical data. Future returns may behave differently from the historical patterns captured in the VCMM. More important, the VCMM may be underestimating extreme negative scenarios unobserved in the historical period on which the model estimation is based.

The Vanguard Capital Markets Model[®] is a proprietary financial simulation tool developed and maintained by Vanguard's primary investment research and advice teams. The model forecasts distributions of future returns for a wide array of broad asset classes. Those asset classes include U.S. and international equity markets, several maturities of the U.S. Treasury and corporate fixed income markets, international fixed income markets, U.S. money markets, commodities, and certain alternative investment strategies. The theoretical and empirical foundation for the Vanguard Capital Markets Model is that the returns of various asset classes reflect the compensation investors require for bearing different types of systematic risk (beta). At the core of the model are estimates of the dynamic statistical relationship between risk factors and asset returns, obtained from statistical analysis based on available monthly financial and economic data from as early as 1960. Using a system of estimated equations, the model then applies a Monte Carlo simulation method to project the estimated interrelationships among risk factors and asset classes as well as uncertainty and randomness over time. The model generates a large set of simulated outcomes for each asset class over several time horizons. Forecasts are obtained by computing measures of central tendency in these simulations. Results produced by the tool will vary with each use and over time.

Connect with Vanguard[®] > global.vanguard.com

Investment Information

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

Simulated past performance is not a reliable indicator of future results.

Past performance is not a reliable indicator of future results.

Any projections should be regarded as hypothetical in nature and do not reflect or guarantee future results.

Important information

For professional investors only (as defined under the MiFID II Directive) investing for their own account (including management companies (fund of funds) and professional clients investing on behalf of their discretionary clients). In Switzerland, this document is directed at professional investors and should not be distributed to, or relied upon by retail investors.

The material contained in this document is not to be regarded as an offer to buy or sell or the solicitation of any offer to buy or sell securities in any jurisdiction where such an offer or solicitation is against the law, or to anyone to whom it is unlawful to make such an offer or solicitation, or if the person making the offer or solicitation is not qualified to do so. The information in this document does not constitute legal, tax, or investment advice. You must not, therefore, rely on the content of this document when making any investment decisions.

The material contained in this document is for educational purposes only and is not a recommendation or solicitation to buy or sell investments.

Issued by Vanguard Asset Management, Limited which is authorised and regulated in the UK by the Financial Conduct Authority. Issued by Vanguard Investments Switzerland GmbH.

Vanguard[®]

Vanguard Research

© 2021 Vanguard Asset Management Limited

© 2021 Vanguard Investments Switzerland GmbH.

All rights reserved

0421/120