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Global Views: Just Clearing the Bar

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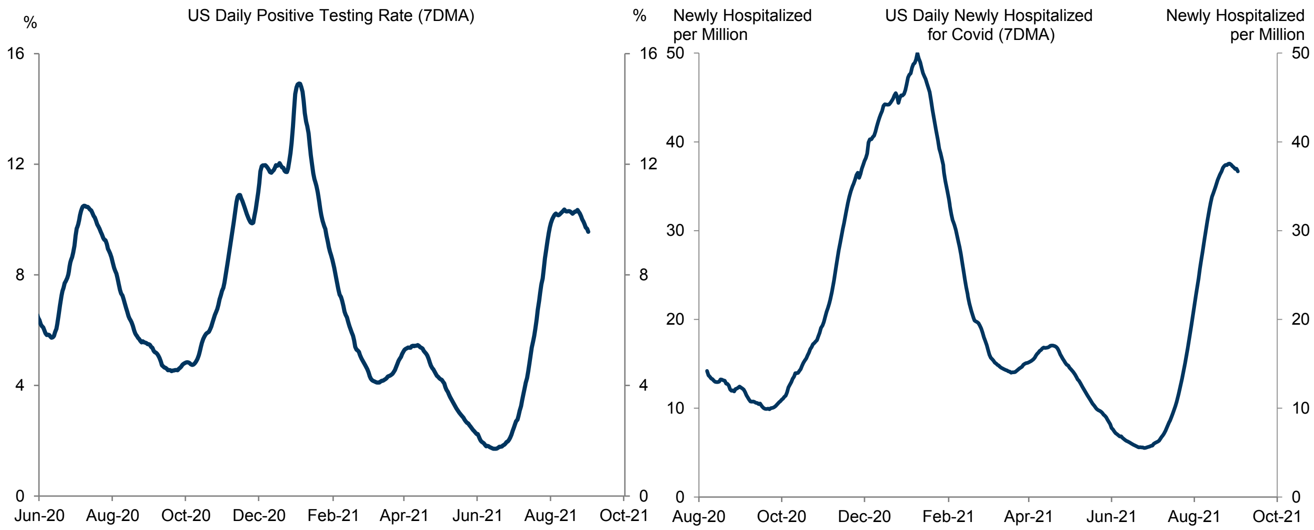
1. The meager 235k US payroll gain in August—nearly half a million below consensus—and the downward revisions to our Q3/Q4 GDP forecasts complicate the near-term Fed outlook, but they ultimately don't change our tapering views. Our subjective probabilities remain 0% for a September announcement—don't forget that the committee has vowed to provide "advance notice"—and then 45% for November, 35% for December, and 20% for a longer delay. We have not pushed back that timeline for two reasons. First, the headline payroll miss overstates the weakness because of a cumulative 134k upward revision to prior months, a 0.2pp drop in the unemployment rate to 5.2%, and a 0.6% gain in average hourly earnings. Second, the Delta fingerprints are all over the recent weakness, with much of the payroll slowdown concentrated in the virus-sensitive hospitality sector. However, there are now signs that the Delta wave is cresting, with a drop in the positivity rate over the last couple of weeks and a more recent decline in new hospital admissions. We therefore expect a job market rebound in coming months and have also offset part of the Q3/Q4 GDP downgrade with stronger numbers in the first half of 2022.

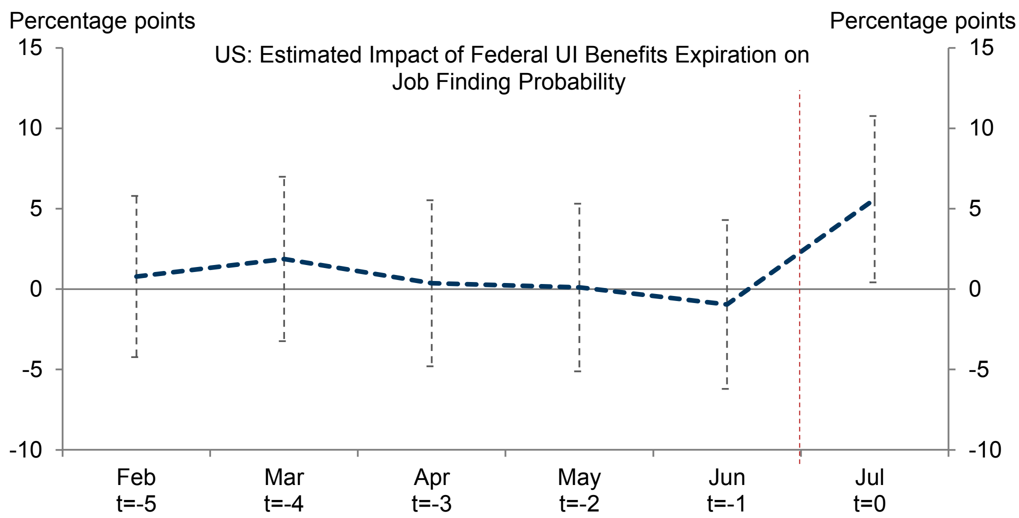
Exhibit 1: The US Delta Wave Is Cresting



Source: CDC, Goldman Sachs Global Investment Research

2. Another reason for near-term optimism on job growth is the imminent expiration of extended and expanded unemployment benefits. Admittedly, there is a vigorous debate about the impact of these benefits among economists. From a conceptual perspective, ending benefits has a positive impact on labor supply but also a negative impact on household income and thus labor demand. Moreover, the July state payroll numbers didn't show stronger gains in red states that ended benefits early than in blue states that kept benefits going. But in practice we would expect the supply effect to outweigh the demand effect given the huge number of job vacancies, and empirically our analysis shows that unemployed workers whose benefits ended early saw a statistically significant increase in their re-employment probability; we put much more weight on this analysis than on comparisons of top-down job growth, which are likely distorted by the fact that red states have seen more Delta spread. So we expect the benefit expiration to boost job growth in coming months.

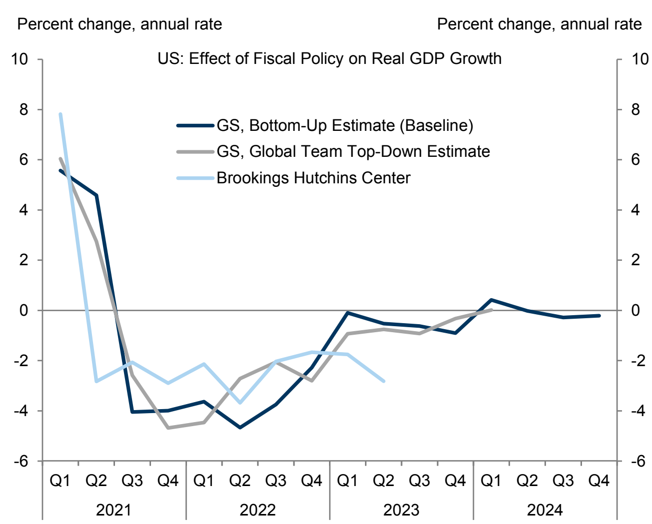
Exhibit 2: Unemployed Workers Find Jobs When Their Benefits End

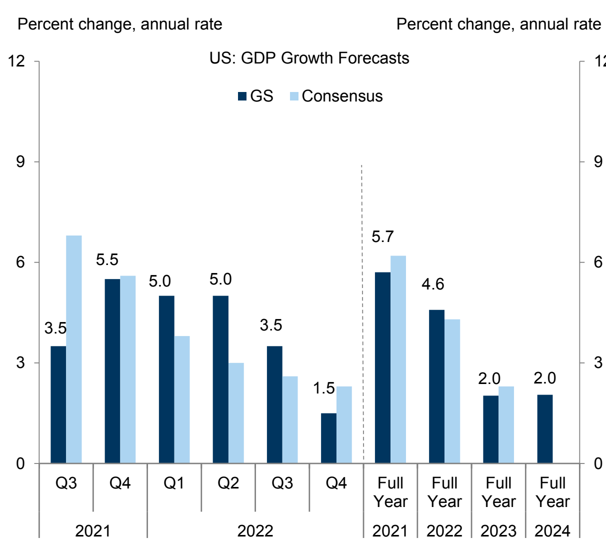


Source: Goldman Sachs Global Investment Research

3. But the recent news does reinforce our view that Fed rate hikes are still far off. If tapering is announced in November and proceeds at a pace of $15bn per meeting, asset purchases will likely end on September 30, 2022. At that point, we expect GDP growth of 2% or less, in part because the reopening impulse will have ended but more importantly because fiscal policy will likely subtract 3pp+ from GDP growth, owing to payback for the enormous boost of 2020-2021. This is despite our assumption that President Biden will manage to pass a longer-term fiscal package worth around $3trn over 10 years, including $550bn for the bipartisan infrastructure package and about $2½trn for the partisan reconciliation package. If the fiscal drag pushes growth below trend in late 2022/early 2023, then rate hikes likely move into late 2023 (our baseline forecast) or even 2024.

Exhibit 3: Fiscal Drag Likely to Push Growth Below Trend in 2022 H2

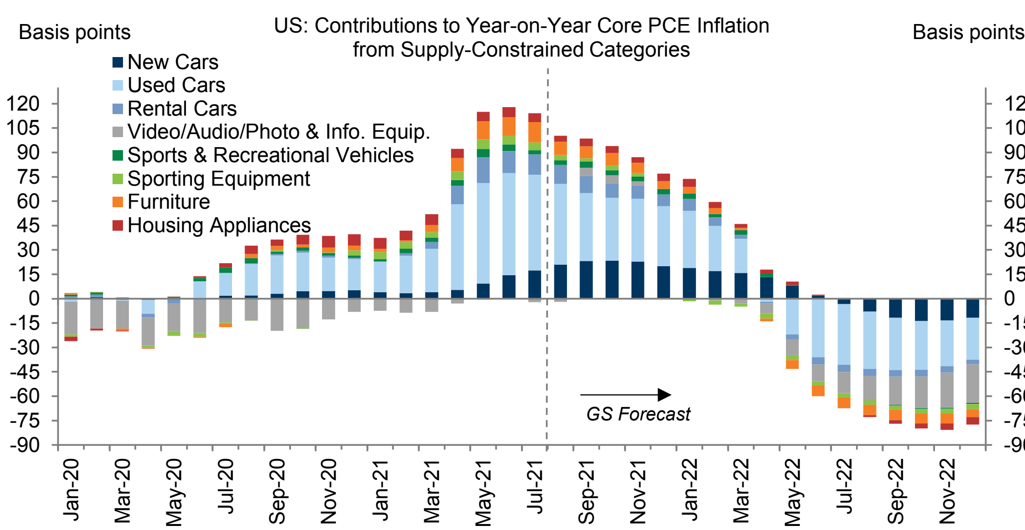




Source: Brookings Institution, Bloomberg, Goldman Sachs Global Investment Research

4. Even if growth proves more resilient, rate hikes may be slow in coming because of below-target inflation. Although our yearend 2021 forecast has moved up further to 3¾%, we still expect core PCE inflation to fall slightly below 2% in 2022 because normalization in autos and other consumer durables should far outweigh rising rent inflation over that period, and a bigger drop is possible given the size of the overshoot in goods prices this year. To be sure, average inflation will remain above 2% for several years, depending on the averaging horizon, but the forward guidance in the FOMC statement effectively rules out hikes when spot inflation is below 2%. The committee could tweak this guidance and adopt AIT language along the lines of the Statement on Longer-Run Goals and Monetary Policy Strategy, but may be reluctant to do so because of worries about undermining the credibility of future commitments. If we see a return to the small but consistent shortfalls of inflation relative to expectations in the 25 years leading up the pandemic, the current forward guidance could thus prove to be a binding constraint on rate hikes for longer than generally appreciated.

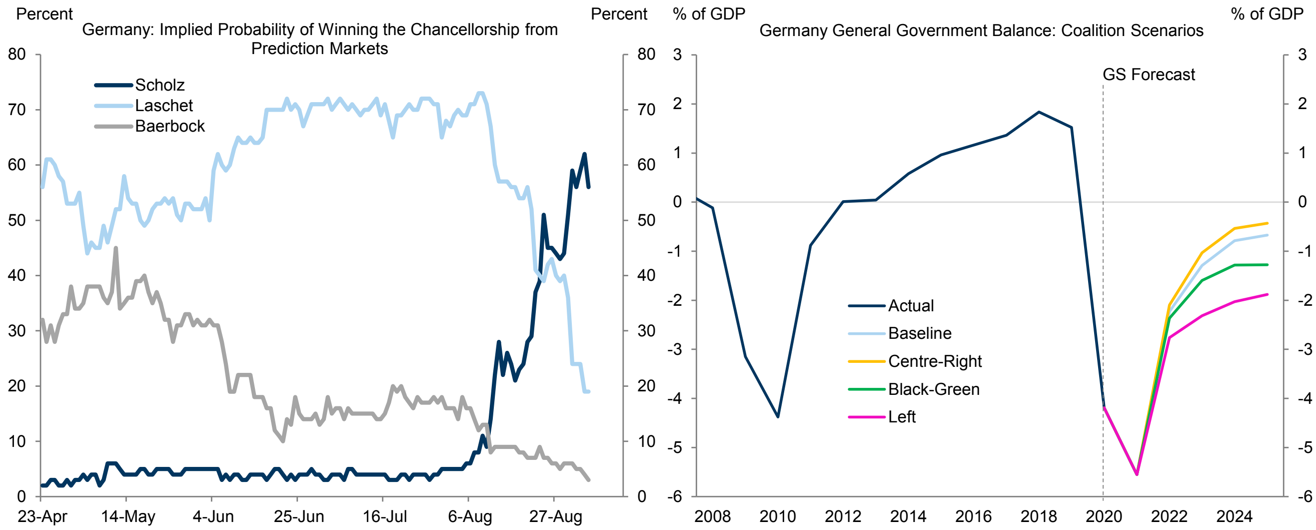
Exhibit 4: A Bigger Overshoot Now Implies a Bigger Drag on Spot Inflation Down the Road



Source: Department of Commerce, Goldman Sachs Global Investment Research

5. Compared with the US, our growth views remain more unambiguously positive in the Euro area. Although the peak sequential growth pace is likely behind us in both economies, Europe is more highly vaccinated, has moved further past the peak of the Delta wave, remains much further below potential output, and will see less fiscal drag than the US. The last point is particularly important if the left-of-center SPD under Finance Minister Olaf Scholz wins the September 26 German election and leads the next government. Our analysis suggests that this would imply meaningful fiscal easing (relative to the baseline) in Germany next year, and probably a more favorable German attitude to fiscal expansion across the broader Euro area as well.

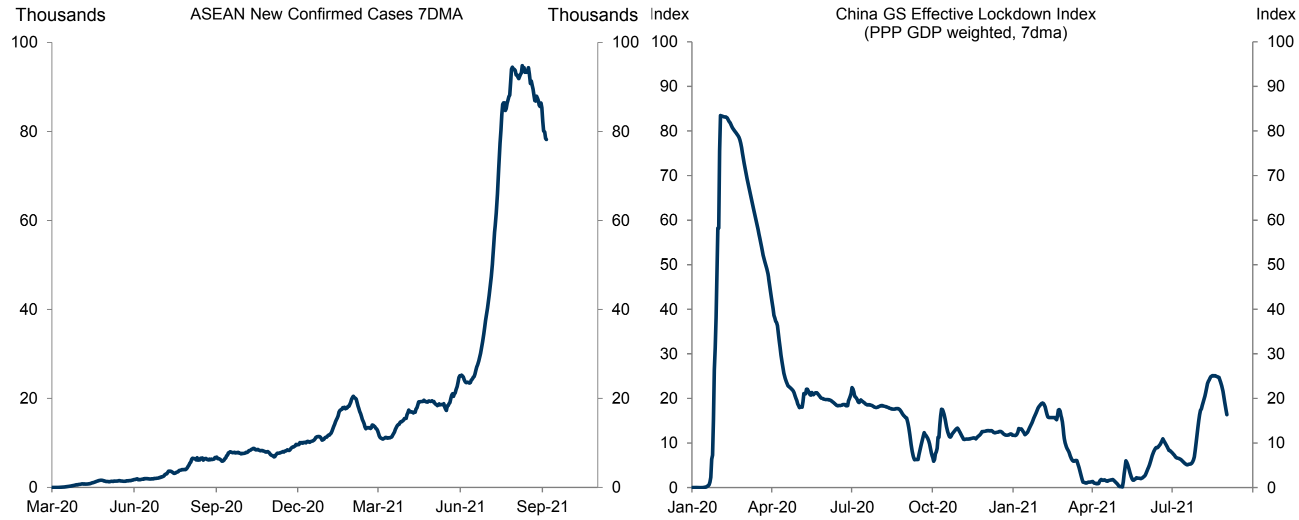
Exhibit 5: A Leftward Shift in Germany Would Result in Easier Fiscal Policy



Source: Predictit, Goldman Sachs Global Investment Research

6. Emerging economies have had a tough six months. First was the catastrophic Delta wave in India during the spring. Next came the inflation surge that forced many EM central banks to pivot toward rate hikes. And most recently, China has clamped down on its Delta outbreak via restrictions that have pushed Q3 growth down to an estimated 1½%, and on a number of businesses via new directives under the banner of "common prosperity." Now, however, the EM outlook is brightening across a number of fronts. In China, new virus cases have come down sharply, restrictions are easing, and we expect policymakers to offset the impact of regulatory tightening with monetary and fiscal easing in a "micro takes and macro gives" environment. In most other Asian countries—including the hard-hit ASEAN region—there are now signs that the Delta wave has peaked, which should set the stage for a rebound in activity. And in both CEEMEA and (especially) Latin America, an improved virus situation remains a clear tailwind for growth.

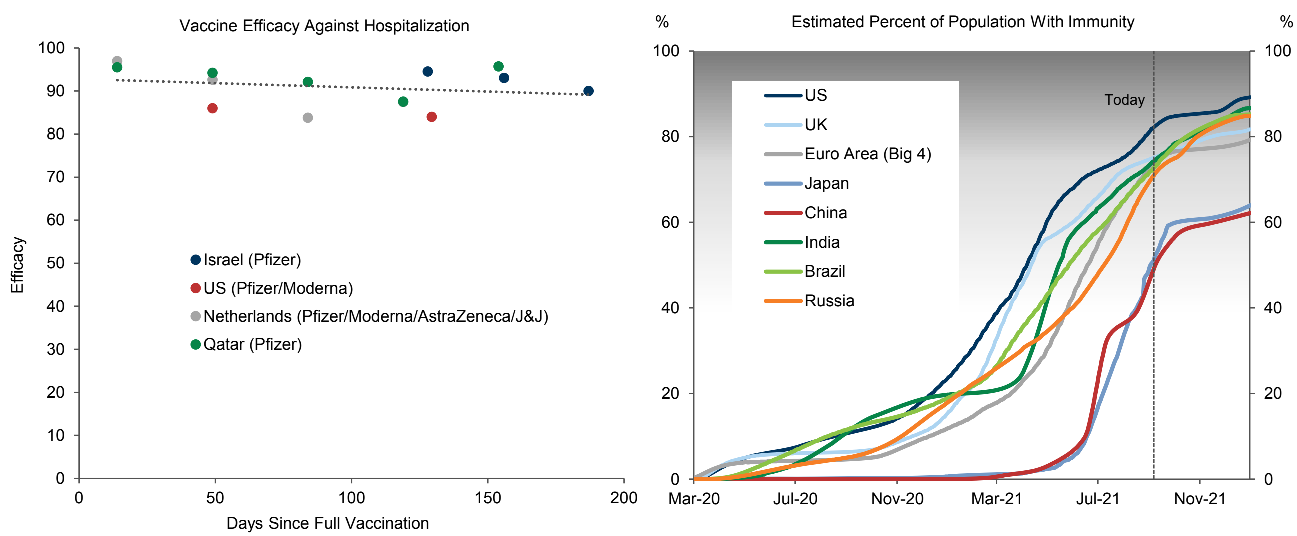
Exhibit 6: Reopening EM as Virus Spread Declines



Source: JHU CSSE, Goldman Sachs Global Investment Research

7. The Delta wave has taught us that vaccination is not a panacea, as protection is incomplete and wanes over time. But it remains true that fully vaccinated patients rarely get severely ill. Based on our estimates of prior infection and the current vaccination pace of about 40 million (or 0.5% of the global population) per day, we continue to expect that 60-90% of the population across the major economies will have some degree of immunity by the end of the year. Moreover, with vaccine supply likely plentiful not only in DMs but also in middle-income EMs, most of the remaining 10-40% could obtain protection if they so choose. This should put the world in a dramatically improved position with regard to hospitalizations, fatalities, and people's willingness to engage in economic activity, barring the emergence of new variants that escape vaccination more fully than Delta.

Exhibit 7: Vaccination Remains a Big Reason for Optimism



Source: Chemaitelly et al. (2021), Rijksinstituut voor Volksgezondheid en Milieu, Goldberg et al. (2021), Goldman Sachs Global Investment Research

8. With all these cross-currents, macro markets remain more tactical than for most of

the pandemic. Our rates and FX teams have re-entered limited US duration and dollar shorts, as positioning looks cleaner than a few months ago and the near-term virus picture is likely to improve. We are also encouraged by a faster-than-expected improvement in credit quality on the back of the reopening, which keeps us broadly positive on credit generally and European high-yield in particular. Nevertheless, we would still "give credit to equity" on an outright basis as the upside remains greater, and also note that short equity volatility strategies look attractive. Finally, we retain our long-standing positive views on commodities, especially copper and oil, where our team expects the recent rebound to run further as microeconomic support outweighs macroeconomic headwinds.

Jan Hatzius

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