ECONOMIC OVERVIEW MONTHLY

March 2021

- The OECD has released its latest economic outlook. Global GDP growth is now projected to be 5,6% this year, an upward revision of more than 1 percentage point from the December projections.

- World output is expected to reach pre-pandemic levels by mid-2021.

- The scale of the response is important - the US has provided since December 2020 more fiscal support to its economy than the Euro Area has done since the start of the pandemic.

CMB MONACO

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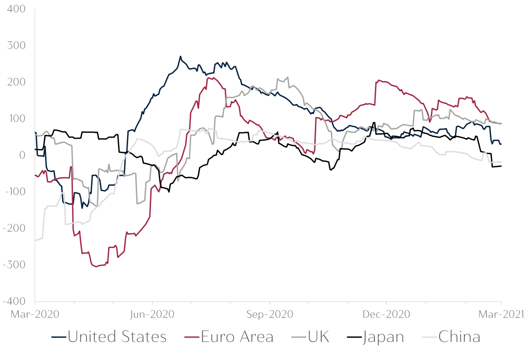
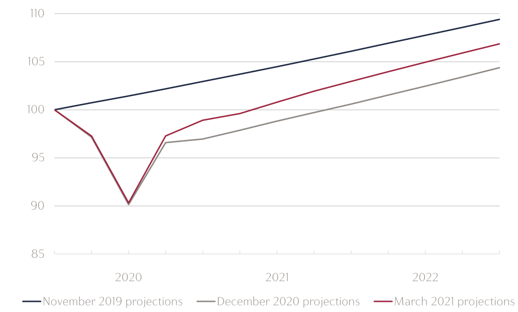
Fig. 1
Growth Expectations - Suprise index



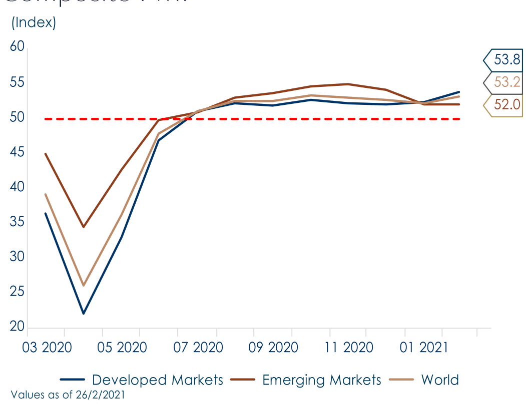
Source: Citi

Fig. 2
Global Growth prospects - World GDP (2019Q4=100)



Source: OECD Economic Outlook

Fig. 3
Composite PMI



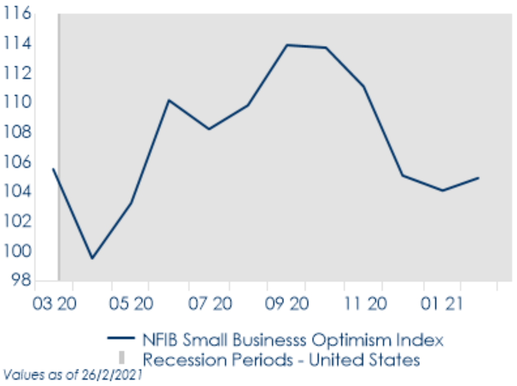
MACROECONOMIC BACKGROUND

Global growth: The medium-term scenario forecasts are for a 2021 characterized by an acceleration of economic growth as we progressively return to normal social distancing thanks to Covid vaccinations. The recovery will be led by China and the United States. The extremely expansionary fiscal policy in the United States will manage to close the US output gap as early as this year. The policy mix will remain extremely accommodating with central banks committed to securing favourable financial conditions through monetary easing programs scheduled to continue well past the end of the public health emergency and fiscal authorities continuing to support growth with large government deficits. All this will have a positive impact on aggregate demand and will favour a significant reduction in the uncertainty that has led households and businesses to accumulate precautionary savings. These savings will begin to be used, further fuelling the virtuous cycle of development. However, in the short term, the speed of recovery in the different geographical areas will be inconsistent and uneven, as it will be conditioned by the evolution of the pandemic but, above all, by the speed of administration of the vaccination campaign, which is affecting and will continue to affect both decisions about new government restrictions and consumer confidence and therefore the recovery of demand.

Global demand: **The OECD has released its latest economic outlook. For Q4 2021, the OECD expects US growth to be a bit higher, +0,2%, than previously assumed relative to the pre-pandemic trend** (November 2019 projections). In contrast, the Euro Area growth rate is expected to be 3,8% lower, as in China where it is expected to be 1% lower. The scale of the response is important - the US has provided since December 2020 more fiscal support to its economy than the Euro Area has done since the start of the pandemic. The release of the February PMIs gives us a snapshot of the global economic recovery, signalling an acceleration for the fourth consecutive month. The JPM Global Composite index rose to 53,2 (from 52,3 in January), the second highest reading in two and a half years and showing continuous expansion for the eighth consecutive month. The improvement was seen in both manufacturing and services, which resumed growth, posting the fastest pace since last October, boosted by reopenings in the U.S.

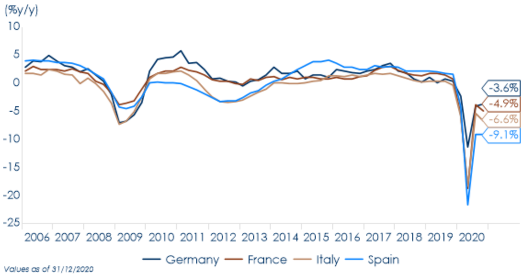
United States: The Senate has approved Biden's $1,9 trillion fiscal relief bill. Key items include $1400 in stimulus cheques, an extension of

Fig. 4
NFIB Small Business Optimism Index



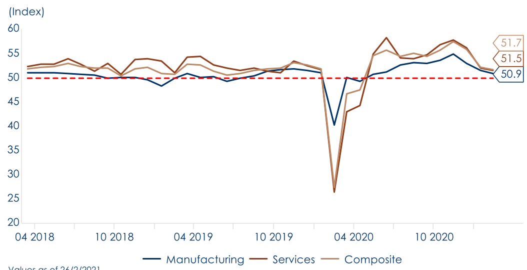
Values as of 26/2/2021

Fig. 5
Real Growth - Euro Area: Main Countries



Values as of 31/12/2020

Fig. 6
China PMI Indices



Values as of 26/2/2021

the $300/week federal benefits for the unemployed, over $360 billion in state and local aid, $160 billion in funding for vaccine and testing Programs, $170 billion to reopen schools.

US consumption is expected to rebound significantly in the coming months due to the effect: 1) of the increase in disposable income of households with high propensity to consume due to tax packages and 2) of the recovery in demand for services in the second half of the year by households with medium to high incomes; 3) of a high level of excess savings accumulated since the start of the pandemic, while rising stock markets and house prices increased wealth. In the months ahead, fiscal stimulus and vaccines should boost consumer confidence, which remains weak for now.

Surveys of economic activity in the United States show that it is an exception in the global landscape. The manufacturing sector remains particularly dynamic and the service sector continues to expand.

The NFIB Small Business Optimism Index began improving again in February, the first increase it had seen in five months. However, the details were not particularly encouraging. Plans to ramp up hiring and capital expenditure increased slightly, but the percentage of firms indicating that now is a good time to expand business plummeted to the lowest level seen since May 2020.

Euro Area: The second wave of Covid-19 has triggered major restrictions in many Euro Area economies. After a better-than-expected end to the year, the first quarter of 2021 is expected to remain negative, as many containment measures remain in place. This should be followed by a consumption-led rebound starting mid-year, as warmer weather allows for a gradual reopening. Retail sales and industrial production for January both paint a pessimistic picture for Q1 2021 growth. The composite PMI remains below the expansion threshold. In addition, here was considerable divergence across countries during the crisis, but we expect most growth paths to converge during the recovery, led by targeted support from the EU Recovery Fund, which will boost growth in the periphery from Q4 2021. The impact of weak demand on inflation remains an important issue for the ECB. Temporary factors will cause inflation to rise but stronger demand will be needed to generate a lasting recovery. Inflation will remain far from the ECB target throughout all of 2021.

China: The most recent surveys, while remaining in expansionary territory, show a recent downturn attributable both to new moderate containment measures and to the start of a modest tightening by the PBoC. The PBOC's "cautious" policy mantra and its desire to avoid sharp turns suggest that the pace of normalisation will depend on data to ensure that growth stays around trend. Inflation excluding the food component remained more or less stable. Producer inflation turned positive but it remains subdued.

ECONOMIC OVERVIEW MONTHLY

Fig. 7
Global vaccine distribution

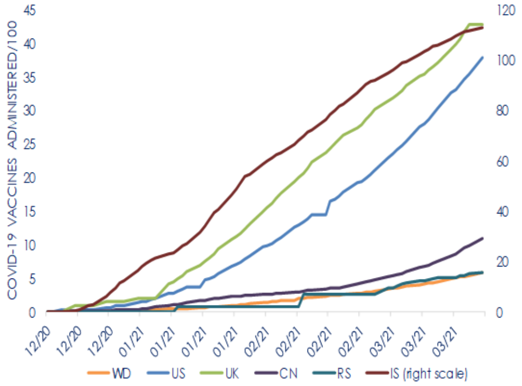


Fig. 8
Vaccination campaign in the Euro Area is slower

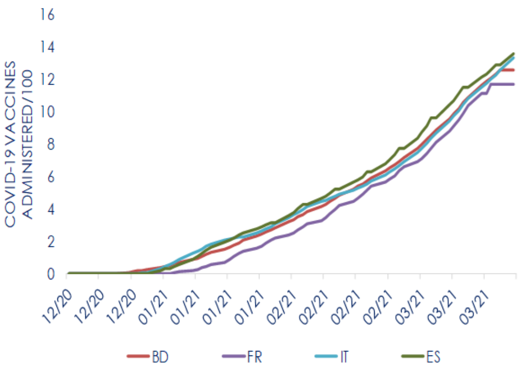
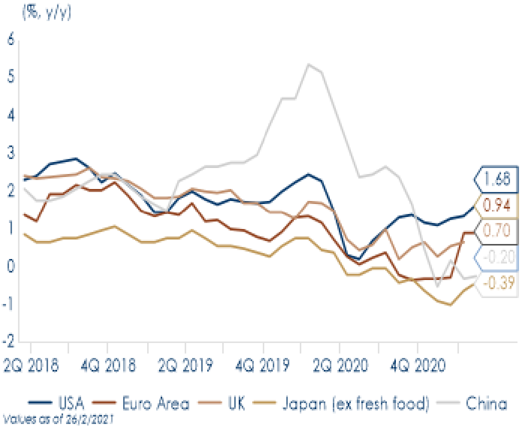


Fig. 9
Consumer Inflation



DISCUSSION POINTS

Virus variants and vaccinations

The ongoing economic recovery remains tied to how the pandemic will evolve. The risks associated with the epidemic have not yet completely disappeared. Global vaccine distribution is gaining momentum at different speeds across the various regions: the US is picking up the pace, Israel reports a drop in the number of hospitalisations, Japan launches its vaccination campaign and the EU continues to experience delays in its vaccination campaign.
Certain European countries could announce new containment measures, which will slow the economic recovery in the first half of the year.

A return to global growth seems within reach and will be guided by the US and China

The economic data published in the first weeks of the year show:

1. a recovery in the manufacturing sector;
2. policy stimulus will remain high. Governments around the world are signalling they will maintain extensive fiscal support, with the U.S. administration leading the way by turning its attention to a multi-year infrastructure package later this year. At the same time, the major central banks are expressing a willingness to maintain accommodative policies, encouraging an overshoot in inflation and a rebound in inflation expectations;
3. proper administration of vaccination campaigns will increase in consumer confidence and consequent spending of accumulated precautionary savings.

Reflation Trade

Government bond markets are reflecting the improvement in macroeconomic prospects around the end of the year. Against the continued backdrop of vigorous monetary policy support and rosier pandemic prognoses, the prospect of stronger fiscal stimulus by the United States triggered the reflation trade: yield curves steepened, breakeven inflation rates rose and the US dollar recovered from its post-election slide.

Inflation remain very low but expectations of a pick-up are rising

Following the approval of the tax package in the United States and the Democratic victories in Georgia, inflation expectations - including both those implicit in the prices of inflation-indexed securities and traders' forecasts - are on the rise again.

Fig. 10

US: Stronger growth and higher inflation expectations in the March SEP

Percent

Variable	Median[1] 2021	2022	2023	Longer run
Change in real GDP	6.5	3.3	2.2	1.8
December projection	4.2	3.2	2.4	1.8
Unemployment rate	4.5	3.9	3.5	4.0
December projection	5.0	4.2	3.7	4.1
PCE inflation	2.4	2.0	2.1	2.0
December projection	1.8	1.9	2.0	2.0
Core PCE inflation[4]	2.2	2.0	2.1	
December projection	1.8	1.9	2.0	
Memo: Projected appropriate policy path				
Federal funds rate	0.1	0.1	0.1	2.5
December projection	0.1	0.1	0.1	2.5

Fig. 11

Despite a firmer outlook, policymakers do not yet see a call to think about rate hikes

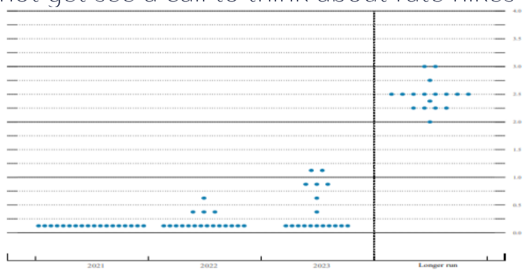
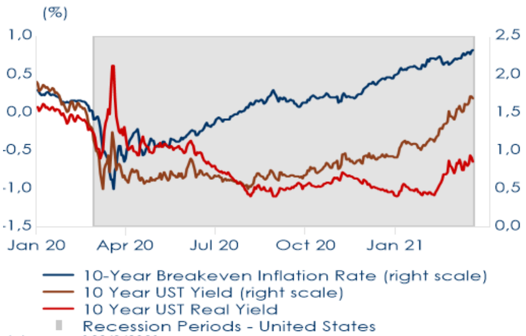


Fig. 12

Overall increas in breakeven inflation



Values as of 22/3/2021

FOCUS OF THE MONTH
THE FED & THE REFLATION TRADE

- In 2021, the Fed will keep rates unchanged and continue its purchase program.

- At the March meeting, the FOMC reiterated its dovish message: a "strong majority" in the committee expects firm rates over the entire forecast horizon, while a discussion of tapering will only begin when data show signs of improvement. Therefore, the growth and employment data of the coming quarters will be crucial in determining the start of the discussion.

- At the same time, the SEPs have outlined an improving macroeconomic outlook.

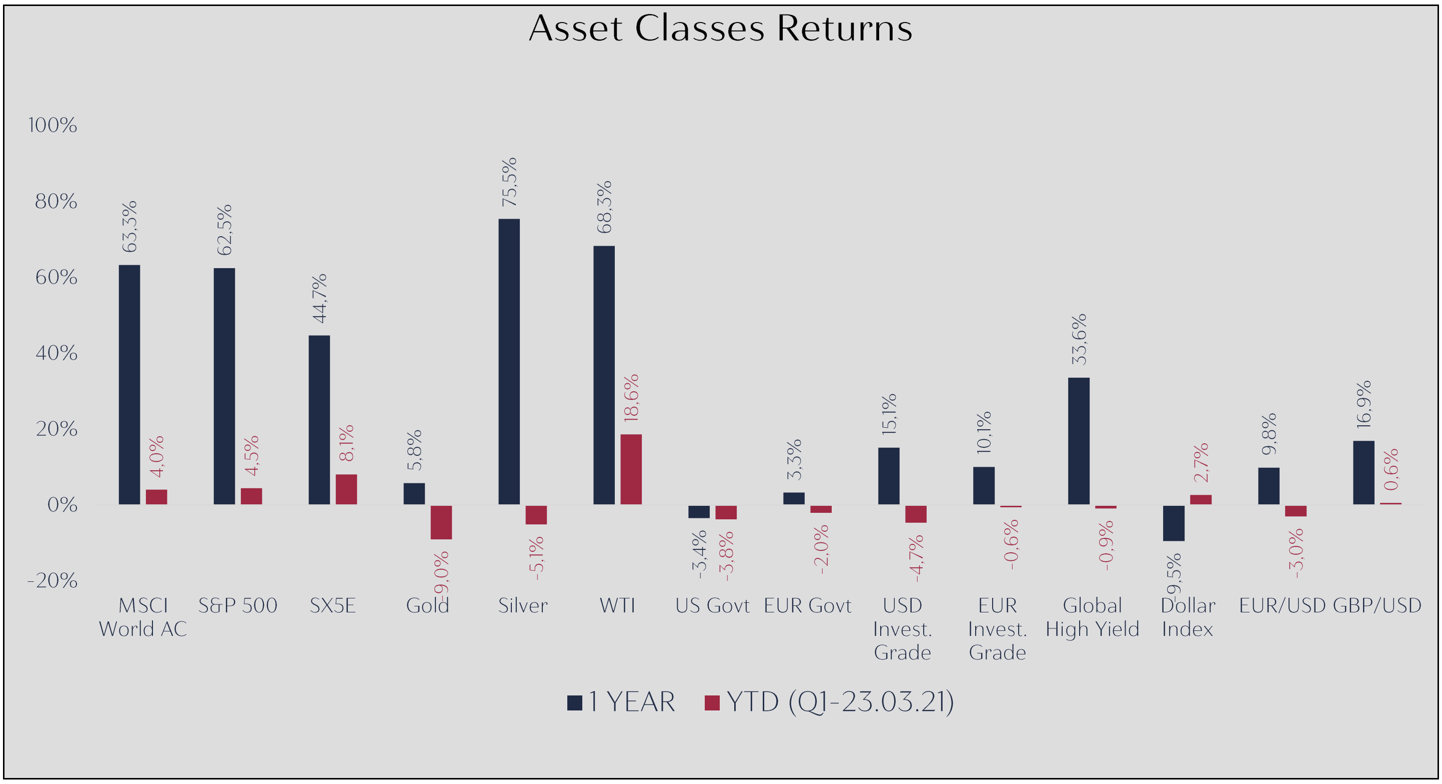
- The path drawn for inflation summarizes a significant message: the FOMC now expects core PCE inflation to remain at or above 2% throughout the forecast horizon - the median projection for core PCE inflation is at 2,2% in 2021, 2,0% in 2022, and 2,1% in 2023 - but this alone is not enough to prompt a hike in key rates. The SEPs reiterate that the FOMC sees an upward inflation outlook, but this trajectory is not sufficient to trigger a rate increase. The primacy of the labor market in the monetary policy reaction function of the Fed is thus reaffirmed.

- The overall increase in breakeven inflation probably reflects a series of signals that US inflation may increase in the short term. In the wake of the Federal Reserve's new monetary policy stance, progress in vaccine distribution, higher commodity prices and significant fiscal stimulus were likely the drivers of higher inflation expectations.

- Supply and demand also contributed to the increase in the inflation premium. The greater supply of Treasuries combined with the smaller supply of TIPS, likely contributed to the higher inflation risk premium. As appetite for inflation hedging has remained constant or increased, investors bid for the yield of the limited number of available TIPS. The relatively low liquidity of the TIPS market has amplified this effect. At the same time, investors are demanding ever higher yield to hold the rapidly expanding amount of treasury bonds.

MARKET UPDATE

2020 ended on a high note, with the discovery of Covid-19 vaccines and the start of vaccination campaigns in all major countries, the Brexit deal and a new fiscal stimulus bill in the United States. 2021 began with Democratic victories in the run-off Senate elections in Georgia, securing Democratic majorities in both branches of the Congress for President Joe Biden and his administration. These events have driven a reflationary movement and an upward recalibration of economic growth forecasts, particularly in the United States. This recalibration process in turn drove the performance of major asset class markets in the weeks between late 2020 and early 2021. The month of February was characterised by a marked reflation trade triggered by the political transition in the United States, expectations of a more expansive fiscal policy and a resetting of growth and inflation expectations. This reflation trade resulted in an increase in the yields of the main government bonds on medium and long-term maturities. The movement originated in the United States and led to a steepening of the term structure of Treasuries, but it also spread to the other side of the Atlantic: yields on long-term government bonds in the Euro Area increased significantly, although remaining at low levels overall.
We expect a gradual economic recovery in 2021 accompanied by a recovery in growth and a rebound in corporate earnings, especially stocks exposed to the cyclical recovery.



RISKS OF SCENARIO

	Main Risks	Risk Evaluation		
		Impact	Probability	Development
ECONOMIC	**World:** The pandemic will continue to be the main obstacle to economic recovery over the winter. If the vaccines distribution is either delayed or less effective, there will be a downside risk to growth, while the recent virus mutation could lead to greater efforts to achieve herd immunity later in the year.	HIGH	HIGH	⬇
ECONOMIC	**World:** US-China relations are likely to remain tense, although the Biden election could lead to a multilateralism return.	HIGH	MEDIUM	⬇
ECONOMIC	**World:** Labour market weakness remains high. In the US, the recovery of the labour market may prove more difficult than expected. In Europe, the risk is that temporary measures will only postpone the moment when unemployment rises.	MEDIUM	MEDIUM	=
ECONOMIC	**United States:** Covid-19 has deeply affected the U.S. labor market and consequently the consumption component, which could remain depressed for a long time if faced with an increase in precautionary savings in the presence of persistent uncertainty about the evolution of the epidemic.	HIGH	MEDIUM	=
ECONOMIC	**United States:** Government bond yield curve steepening.	HIGH	MEDIUM	⬆
ECONOMIC	**United States:** Fed exit too early on easy monetary policy in the event of a sudden rise in inflation.	HIGH	LOW	=
ECONOMIC	**Eurozone:** Eurozone countries economic asymmetry is increasing. The COVID-19 has asymmetrically affected the Eurozone countries, which have been able to implement different fiscal measures and, above all, will have to face different financing conditions on the markets.	HIGH	MEDIUM	⬆
ECONOMIC	**Euro Area:** Euro Area Inflation remained in negative territory. The area risks slipping into deflation.	HIGH	HIGH	=
ECONOMIC	**Emerging countries:** The main scenario risk is that of a sudden slowdown in capital flows to emerging economies, which amplifies their degree of vulnerability and brakes their growth.	HIGH	LOW	⬇
POLICY	**Euro Area:** Credit standard tightening on the back of phasing-out of state guarantees.	HIGH	LOW	=
POLICY	**Euro Area:** There is a risk of execution of the Next Generation EU tax plan.	HIGH	MEDIUM	⬇
POLITICAL	**World:** There is a progressive loosening of global cooperation.	HIGH	HIGH	⬇
POLITICAL	**World:** Geopolitical issues (e.g. Hong Kong, Latin America...) continue to present many unresolved elements. The results could spark a new screwiness in the world economy and weigh on the recovery.	MEDIUM	MEDIUM	=

POSITIONING

In this scenario:

- we are taking a **negative view** of **core European government bonds**. We prefer peripheral bonds to core European countries, also in light of the Draghi government's takeover. We remain **neutral on US government bonds**;
- the **corporate bond market** is **not yet offering attractive valuations**, although the support provided by the purchases of central banks, **especially the IG component**, remains significant;
- we are maintaining our **positive view of equities**. Even after the recent recovery, we see forecast 12-month returns on equities as more attractive than those for fixed income, in line with **an economic cycle** that, according to our base scenario, **will rebound with the support of policy makers**. We continue to favour emerging market equities and the Chinese stock market in particular, assuming the country's higher relative growth. The Euro Area stands to benefit from the change of pace in fiscal policy.

	NEGATIVE		NEUTRAL		POSITIVE
FIXED INCOME			●		
Sovereign EUR	●				
Sovereign USD			●		
Corporate IG			●		
High Yield			●		
Emerging Market Sovereign			●		
EQUITY				●	
USA			●		
EMU				●	
JAPAN				●	
Emerging Market				●	

Source: CMB Monaco, Mediobanca SGR