ECONOMIC OVERVIEW MONTHLY

May 2021

- The world economy is now in a phase of significant acceleration in economic growth, led by the United States where the business cycle indicator puts the country in an overheating phase.
- Economic data continue to exceed expectations and forecasts from leading observers are gradually being revised upwards.
- Accelerating economic growth will require central banks to properly calibrate the slowdown of their expansionary monetary policies.

CMB MONACO

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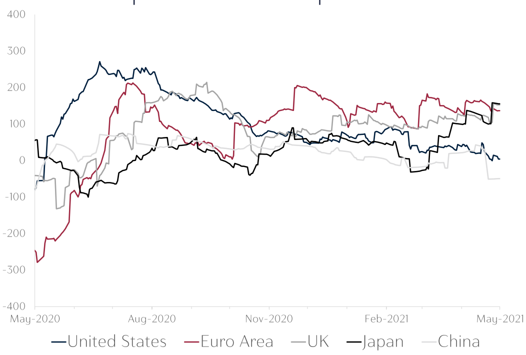
Fig. 1
Growth Expectations - Suprise index



Source: Citi

Fig. 2
OECD leading indicators

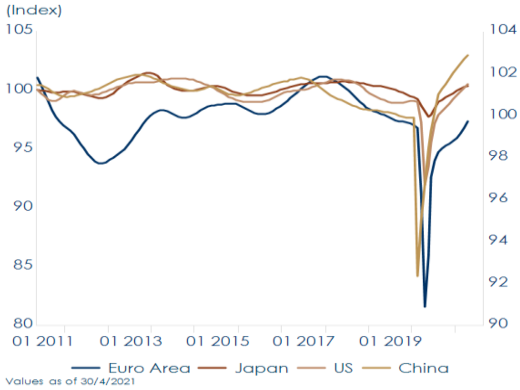
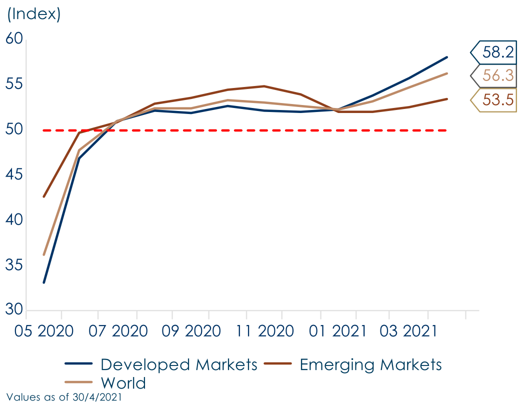


Fig. 3
Composite PMI



MACROECONOMIC BACKGROUND

Global growth: The global economic outlook improved markedly in the first months of the year, helped by vaccination campaigns, announcements of further fiscal support and the resilience of the manufacturing sector to pandemic containment measures. The world economy is now in a phase of significant acceleration in economic growth, led by the United States, which has introduced a significant fiscal stimulus. In the short term, the economic recovery will not be uniform, neither between sectors (manufacturing vs services) nor between regions, as it will be conditioned by the speed of administration of the vaccination campaign. China, which came out ahead of the pandemic, has seen its growth peaking; the US is entering its strongest quarter; the Euro Area is lagging behind, mainly due to inefficiencies in vaccination campaigns, but the second half of the year should see a pick up in the growth rate, supported by the international recovery and the implementation of the Next Generation EU. Japan should cross the bottom of the "U" shape recovery.

Global demand: Economic data continue to exceed expectations and forecasts from leading observers are gradually being revised upwards. Consumption shifted from services to goods in the first quarter, benefiting manufacturing exporters and supporting the recovery in global trade. Once the restrictions are lifted and the fear of a pandemic subsides, the tertiary sector should return to a path of sustained growth and benefit from the consumption of precautionary savings.
Growth in global economic activity accelerated to an 11-year high in April, according to PMIs. The recovery in manufacturing has been led by solid expansions in the US - survey record - and in the UK, while growth has been weak in Japan. Brazil is the only country that exhibited lower activity.
The rise in the global manufacturing PMI suggests that the strong recovery in industrial production continued in April, but supply constraints continue to drive prices upwards around the world. In April, the rate of increase in service activity exceeded that of manufacturing output for the first time since the current recovery began last July.
Inflationary pressure is also perceived in price indices. Input costs have risen at the fastest pace since mid-2008, with increases accelerating for manufacturers and service providers alike. Companies responded by raising their production costs, leading to the sharpest increase in sales prices since data on expenses started being collected in October 2009.

Fig. 4
US PMI Indices

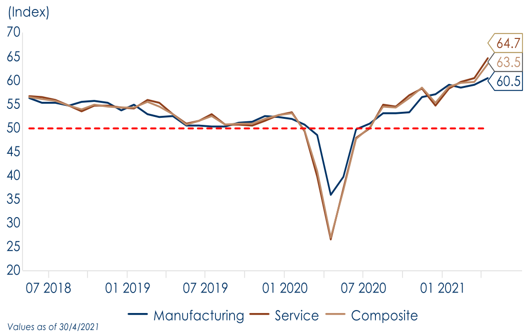


Fig. 5
Euro Area PMI Indices

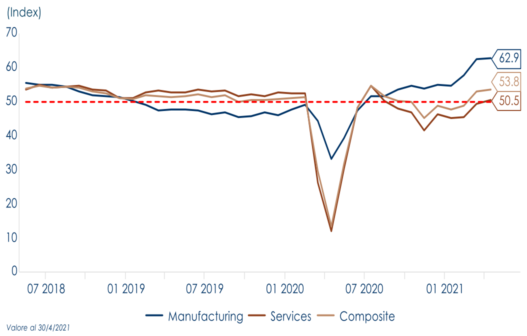
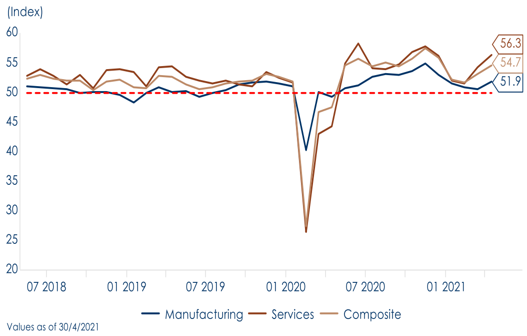


Fig. 6
China PMI Indices



United States: The US will lead global growth in 2021. The business cycle indicator puts the country in an overheating phase. Economic activity will continue to gain strength in the coming months thanks to the availability of Covid vaccines, while further fiscal stimulus will act as a reflationary bridge to support the more cyclical sectors of the economy. GDP growth for 2021 should be the strongest in decades. Over the past month, we have seen a labour market report that was difficult to interpret and turned out to be worse than expected, with a net gain of only 266000 jobs and a slight increase in unemployment to 6,1%. In addition, the ISM index appears to have peaked, but the new orders component remains strong and above the aggregate index, showing that the manufacturing index will remain solid for another few months. Finally, the consumer and producer price indices for April showed that upward pressure is beginning to be reflected in the prices of goods sold.

Euro Area: Economic activity in the Euro Area was affected by the evolution of the pandemic and the slow vaccination programme. It reported negative growth in the first quarter of the year, but should catch up with global growth from the second quarter onwards. Manufacturing remains strong in all the countries of the Area. Economic indicators point to a large gap to be closed between the manufacturing and service sectors, as the former has already started to benefit from the global economic rebound. The ECB announced that it is scaling back its bond-buying programme to ensure accommodative financial conditions. The fiscal policy will remain supportive. In the second part of 2021, the NGEU fund will provide further support by stimulating investment. In the meantime, the recovery continues and fiscal support remains strong. Temporary factors will cause inflation to rise but stronger demand it is necessary to generate a lasting recovery. Inflation will remain far from the ECB target throughout all of 2021.

China: GDP growth jumped from 6,5% y/y in Q42020 to 18,3% y/y in Q12021, supported by a strong favourable base effect. The country's economy remains positive beyond the base effect. Industrial production rose 35% y/y in February and 14% y/y in March, exports and imports of goods in yuan grew 58,6% and 18,8% respectively in Q12021, while infrastructure investment rose 33% on average in February and March. Private consumption also rebounded, recording a positive contribution to GDP growth in Q12021 (11,6 pp of 18,3% y/y GDP growth), after a negative contribution in all four quarters of 2020. Soft data for April offers the same positive picture. Thus, the PPI is showing price pressures.

Fig. 7
New cases are on the decline once again

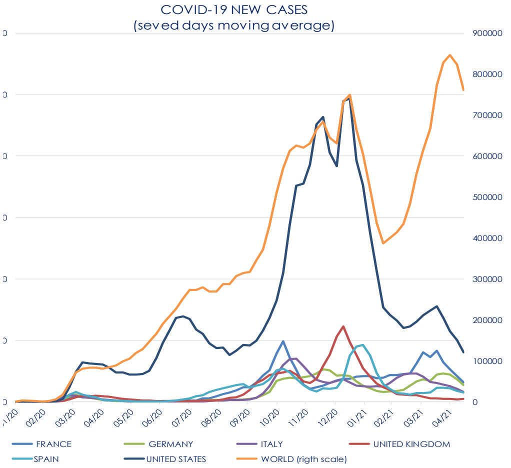


Fig. 8
The vaccination campaign in the Euro Area is accelerating

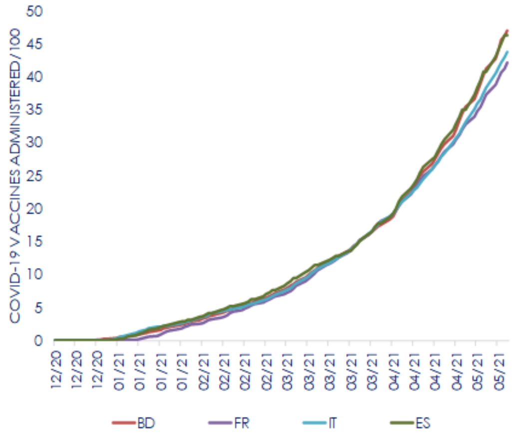
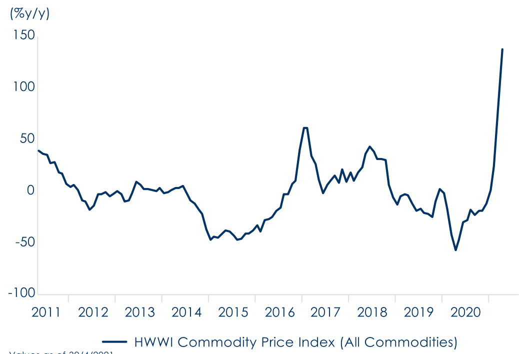


Fig. 9
HWWI Commodity Price Index



Values as of 30/4/2021

DISCUSSION POINTS

Evolution of the pandemic

New infections seem to have peaked and new cases are gradually decreasing. The vaccination campaign continues in developed countries. Vaccination programmes are clearly working in the US and the UK. In the Euro Area, restrictions and perhaps some initial benefits from more widespread vaccine uptake have meant that the number of cases has been on a downward trajectory since the end of April. In Japan, the fourth wave of infections seems to have peaked.

Economic recovery continues...this time it should be the Euro Area's turn

The economic recovery continues. Almost all of the countries we analysed show a positive and accelerating growth momentum. However, fiscal policy and the conditions in which countries entered the Covid crisis will affect the growth rates of individual economies.

Will the rise in inflation be temporary? Will it be uniform between countries?

Rising commodity prices, difficulties in international trade and shortages of cargo in the face of imbalances between supply and demand have led to higher producer prices. This inflationary drive began to be felt in April in prices of consumer goods.

How soon will central banks prepare to normalise monetary policy?

Monetary policy will continue to be accommodating. However, the central banks of the main developed countries are now grappling with a reshaping of their monetary policies, which are still largely expansionary. It will be necessary they properly communicate the transition to the new monetary policy phase in order to avoid jeopardising the ongoing economic recovery and triggering a sudden tightening of financial conditions.

Fig. 10

The NRRP is providing support to the cyclical recovery (high scenario)

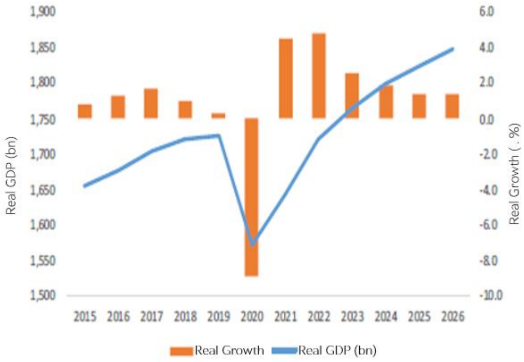


Fig. 11

Macroeconomic impact of the NRRP (percentage deviations from the baseline scenario)

	2021	2022	2023	2024	2025	2026
GDP	0,5	1,2	1,9	2,4	3,1	3,6
Private Consumption	-0,2	-0,6	-0,6	0,0	1	1,9
Total Investments	2,8	7,6	11,6	12,5	11,8	10,4
Imports	0,2	1,0	1,9	2,7	3,4	4,0
Exports	-0,2	-0,5	-0,2	0,6	1,6	2,7

Source: MEF-DT

Fig. 12

Macroeconomic impact by components (percentage deviations from the baseline scenario)

	T+5	T+10	Long Run
Public Administration reform			
GDP	1,0	1,8	2,3
Private Consumption	1,1	1,8	2,3
Total Investments	0,5	1,5	2,2
Justice reform			
GDP	0,2	0,4	0,5
Private Consumption	0,2	0,4	0,5
Total Investments	0,1	0,3	0,5
Competition Policy reform			
GDP	-0,2	0,3	-0,6
Private Consumption	-0,1	0,1	0,3
Total Investments	0,8	0,9	1,1
Global impact of reforms			
GDP	1,4	2,5	3,3
Private Consumption	1,2	2,3	3,1
Total Investments	1,4	2,7	3,8

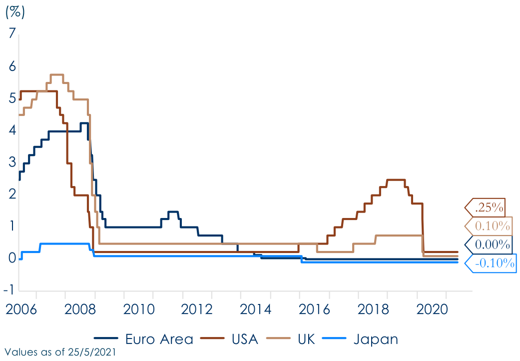
Source: MEF-DT

FOCUS OF THE MONTH - 1/2
THE ITALIAN NRRP

- The Italian Government designed the National Recovery and Resilience Plan (NRRP) as an integrated plan of investments and reforms.
- The NRRP represents a unique opportunity for Italy, capable of driving economic growth and preventing it from slipping into a dangerous debt spiral.
- Italian success in using Next Generation EU funds could facilitate greater fiscal integration at European level.
- Downside risks to short-term expectations are linked to the actual **disbursement of funds to member states** in the initial phase and efficiency in public procurement and the spending of money at national level in the subsequent phase.
- **The NGEU is a once in a lifetime opportunity which should boost economic growth.** Failure to seize this opportunity would not release Italy's growth potential, leaving the country with a debt level in excess of 150% of GDP by the end of this decade. The latter would represent a major risk for both Italy and the EMU.
- **The success of the Italian plan would increase cohesion within the Euro Area, enabling a process of greater debt sharing, while working towards a common federal budget.**

Fig. 13
The Fed and the ECB polices remain expansionary, even if in different contexts of inflation and growht

Fig. 14
Central Bank reference rates

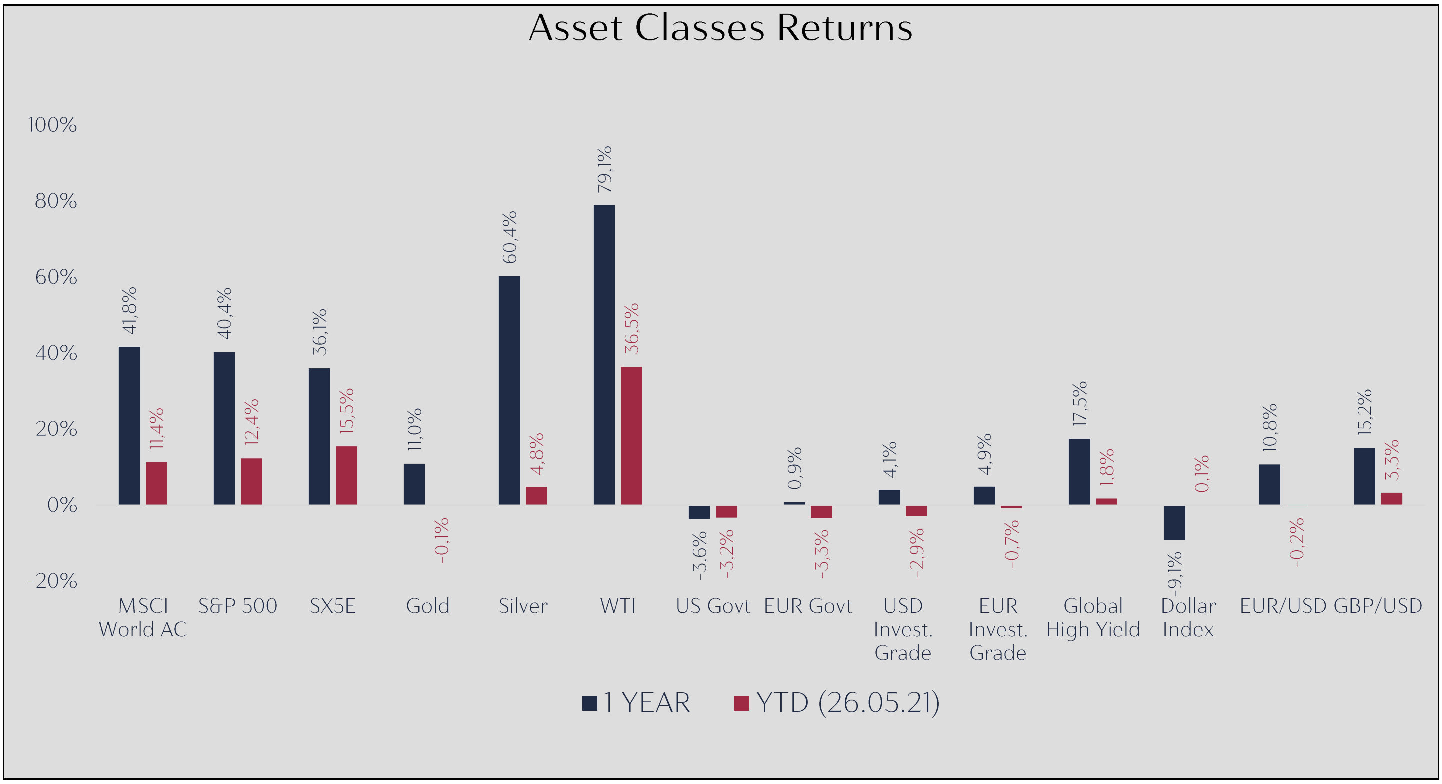


FOCUS OF THE MONTH - 2/2
MONETARY POLICY

- Accelerating economic growth will require central banks to properly calibrate the slowdown of their expansionary monetary policies.
- Their communication will play an important role to ease market reactions, avoiding the counterproductive tightening of financial conditions.
- The structure of individual economies and the evolution of the vaccination campaign will dictate the timing for individual countries. **The Fed and the ECB policies remain expansionary, even if in different contexts of inflation and growth. Euro Area growth should return to pre-Covid levels by mid-2022.**
- **The FOMC kept the stability signal unchanged in April**, reiterating that it will wait to see a solid labour market recovery before starting talking about tapering. Although tapering may be announced as early as the end of this year, the increase in the cost of money will take place no earlier than 2023.
- However, markets are expecting the first rate hike in the second half of 2022 and seem to be looking for confirmation of the future change in monetary policy in every piece of data and statement released (dissonance between what the market is pricing and what the Fed keeps repeating).
- In June, the ECB is due to publish its growth and inflation forecasts and make another statement concerning the PEPP.
- In August, the annual Jackson Hole meeting could be an opportunity to introduce the discussion about tapering.

MARKET UPDATE

The global economic outlook improved markedly in the first months of the year, helped by vaccination campaigns, announcements of further fiscal support and the resilience of the manufacturing sector to pandemic containment measures. The 2021 recovery will carry over positively into 2022, so we expect a significant rebound in corporate earnings, especially stocks exposed to pro-cyclical growth. Over the coming months, we expect reflation to materialise in the outperformance of equity markets and the more cyclical sectors (Europe, Japan, EM; Financials, Energy, respectively), and of the Value versus Growth style. The dollar is set to weaken in this initial phase, weighed down by the public deficit, reduced private savings and increased (deficit) investment, which will produce a marked deterioration in external balances.



RISKS OF SCENARIO

	Main Risks	Risk Evaluation		
		Impact	Probability	Development
ECONOMIC	**World:** The pandemic will continue to be the main obstacle to economic recovery. An uncontrolled spread of infection in some emerging countries could postpone the end of the global health crisis.	HIGH	HIGH	↓
	World: US-China relations are likely to remain tense, although the Biden election could lead to a multilateralism return.	HIGH	MEDIUM	=
	World: After the increase in inflation due to base effects and supply-demand imbalances produced by the pandemic, an inflationary spiral could be triggered on the back of a structural change in the Philipps, influenced both by the new tax regime of the Biden administration and by an reshoring phenomena intensification after the Covid interrupted long stretches of "low cost" supply from East to West.	MEDIUM	MEDIUM	↑
	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	↓
	United States: Government bond yield curve steepening.	HIGH	MEDIUM	↑
	United States: Fed exit too early on easy monetary policy in the event of a sudden rise in inflation.	HIGH	LOW	↑
	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	↑
	Euro Area: Euro Area Inflation remained in negative territory. The area risks slipping into deflation.	HIGH	HIGH	=
	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	=
	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	=
	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 remain neutral on US government bonds.** Emerging market debt scores favourably on the source of higher carry;
- 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, **while Italy should benefit from the authority, stability and competence of Prime Minister Draghi**.

	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