ECONOMIC OVERVIEW MONTHLY

July 2021

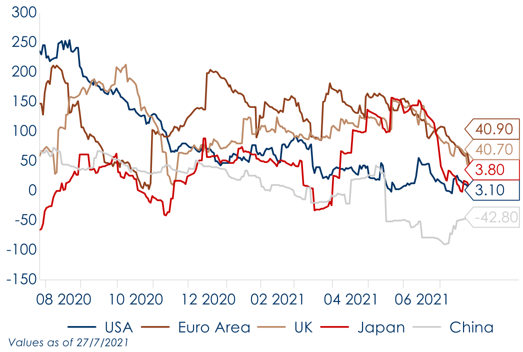
- Although central banks consider recent inflationary pressures to be only temporary, actual figures will overshoot their official targets and the Fed's in particular by far.
- Monetary policy will remain accommodating However, central banks of the major developed countries are now grappling with a reshaping of their monetary policies, which are still largely expansionary.
- Tax stimulus and central banks stance should continue to support the economic recovery well beyond 2021.

CMB MONACO

ECONOMIC OVERVIEW MONTHLY

- The success of several vaccination campaigns, supported by broadly accommodative and coordinated monetary and fiscal policies implemented since the start of the pandemic, has made growth strong on both sides of the Atlantic.
- Bottlenecks in production chains and price pressures have continued to materialize.
- Global PMIs in June corrected marginally but remained at elevated levels, especially in advanced economies, which are recovering faster than emerging economies.

Fig. 1
Growth Expectations - Suprise index



Source: Citi

Fig. 2
Maritime transportation costs worldwide

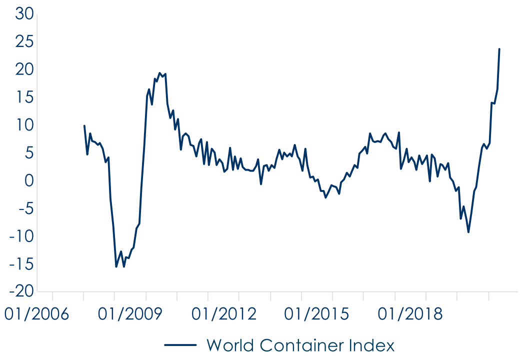
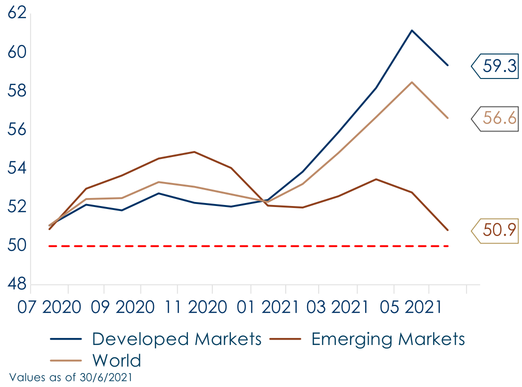


Fig. 3
Global Composite PMI



MACROECONOMIC BACKGROUND

Economic growth is sharply accelerating:

In 2020, Government implemented restrictions in response to the spread of COVID constituted the most significant limitation on economic activity. The success of several vaccination campaigns, supported by broadly accommodative and coordinated monetary and fiscal policies implemented since the start of the pandemic, has made growth strong on both sides of the Atlantic. China performed strongly as well as the majority of the Asian countries connected through production supply chains. Many progresses were made towards resolving the public health crisis, which were followed by the reopening and restart of entire sectors heavily penalized over the past year due to lockdowns. We expect to witness an increasingly consolidated and geographically widespread recovery sustained by several factors: first, household consumption, as households and businesses begin spending the precautionary savings that they had accumulated during the long period of uncertainty. Second, by accommodative fiscal and monetary policies and finally by business investments which were postponed due to complete lack of visibility on economic activity.

Bottlenecks in production chains and price pressures have continued to materialize. Supplier delivery times have further lengthened, hitting a new record high, and backlogs have fallen only slightly from a very high level. Price indices are still at very high levels, consistent with strong inflationary pressure, although the latest decline may suggest that this pressure has begun to ease.

Global PMIs in June corrected marginally but remained at elevated levels, especially in advanced economies, which are recovering faster than emerging economies. The PMIs also suggest that price pressures continue to increase. Looking at the breakdown by sector, the global services index fell more than its manufacturing equivalent: this largely reflects a decline in the US where the initial acceleration linked to the reopening has faded.

Fig. 4
US PMI Indices

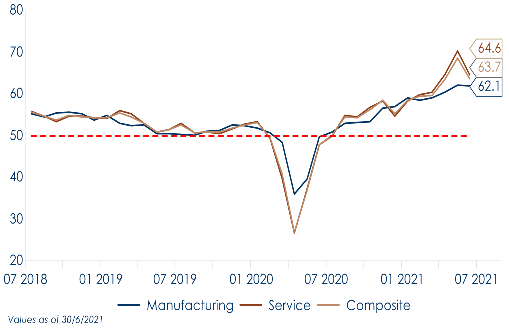


Fig. 5
Euro Area PMI Indices

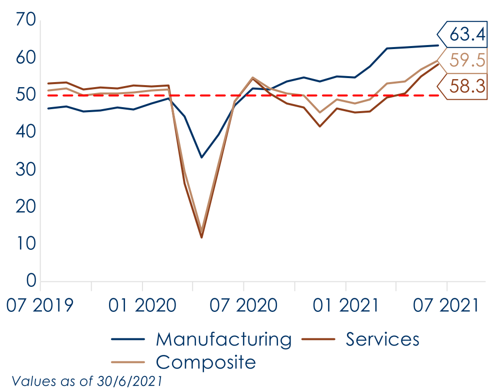
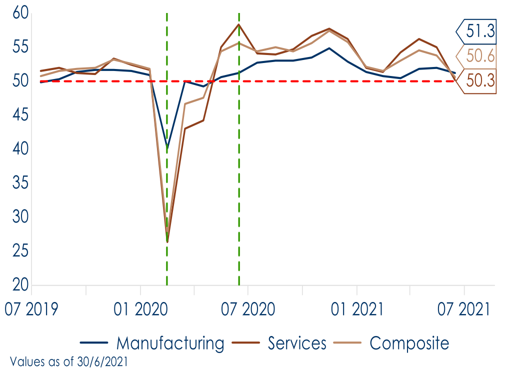


Fig. 6
China PMI Indices: first in, first out of the global Covid crisis...



United States:

The US will lead global growth in 2021. The business cycle indicator puts the country in an overheating phase. Growth was spurred not only by expansionary monetary policy but also by an unprecedented fiscal stimulus, which has allowed the growth rate to return to its pre-pandemic trend. The Beige Book, prepared for the FOMC meeting at the end of July, shows that supply bottlenecks are increasing, with material and labour shortages, delivery delays and insufficient stocks, which are particularly pronounced in the auto industry but widespread overall. Moreover, price pressures could last for several more months, complicating monetary policy. CPI inflation reached 5.4% in June while core inflation stood at 4.5%, the highest on record since 1992.

Euro Area:

Progressive vaccinations and the low number of new infections have allowed for the gradual lifting of restrictions on economic activity, which has picked up as a result. In June, the Euro Area composite PMI reached a 15-year high, driven by a strengthening in the services sector, which is benefiting in particular from the reopening. The recovery appears to be driven by services and commerce, the sectors that were the most penalized previously but which stand to benefit the most from the effect of reopening, with manufacturing remaining a positive contributor. Short-term inflationary pressures remain the focus of market attention, but in our view and that of the ECB, they will prove to be temporary.

China:

Economic growth has probably peaked and should start to slow in the second half of the year. However, Chinese growth remains high, supported by strong foreign demand. China will not lead global growth in 2021, but its growth will remain solid and will not translate into weakness for other regions. As long as inflation does not rise more sharply than expected, Beijing may decide to moderate the normalization of credit growth by recalibrating the current economic policy package. In July, the People's Bank of China (PBoC) announced a 50-bp cut in the reserve requirement ratio (RRR). This decision drew markets' attention to the Chinese authorities' caution with respect to potential downside risks to economic growth. Markets interpreted the decision as a dovish and pre-emptive move, necessary to stabilize economic growth and support SMEs struggling with sharply rising producer prices that are eroding their profit margins and to make it easier for smaller banks to recognize non-performing loans.

ECONOMIC OVERVIEW MONTHLY

Fig. 7
Economic recovery supported by strong consumer confidence rebound

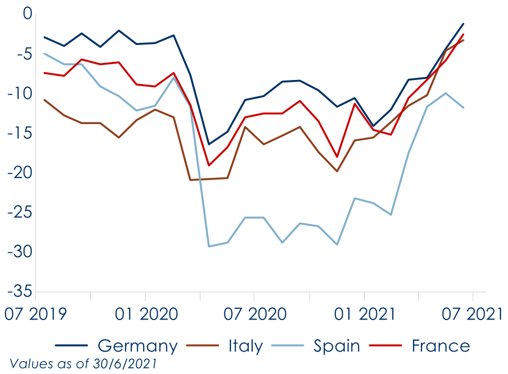


Fig. 8
New infections are on the rise once again

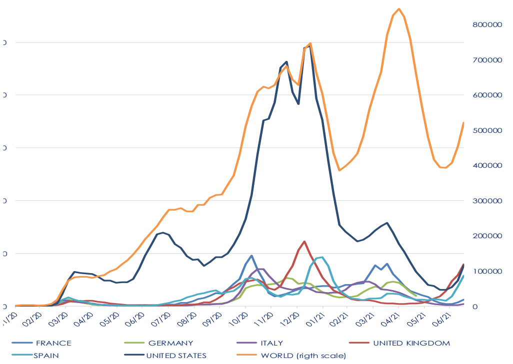
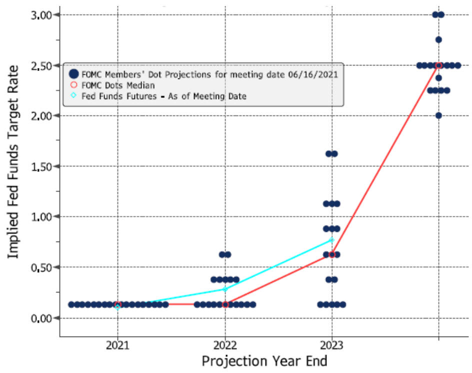


Fig. 9
Implied FED funds target rate



DISCUSSION POINTS

Economic recovery continues...

Tax stimulus and central bank prudence should continue to support the economic recovery in 2022. Developed countries have peaked in terms of the pace of vaccinations, economic indicators, liquidity and fiscal relief, so they are entering a transition phase toward still solid but more differentiated economic growth.

The Covid-19 Delta variant is raising concerns and constitutes a downside risk to growth.

The emergence of new strains of COVID-19 and differences in the pace of vaccination campaigns are causing some concerns about the speed and strength of economic recovery. In this context, emerging market economies are in the weakest position, having lower vaccination rates.

Will inflationary pressures be transient?

The exit from the pandemic has generated temporary imbalances between supply and demand, which have driven up commodity and producer prices in recent months, upward pressures that are beginning to spread to consumer prices. Although central banks consider this acceleration to be only temporary phenomenon, actual figures will overshoot their official targets and the Fed's in particular by far.

Taper or not to taper? Will central banks prepare to normalize their monetary policies?

Monetary policy will remain 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 is likely that the official course will be charted at the end of the summer, leading to the tapering of asset purchases to zero, which is reasonably expected to start in the first quarter of 2022 and should take at least a year to complete. Central bank announcements and the pace of nominal rate increases will determine the performance and volatility of financial markets in the next phase.

Fig. 10
Consumer inflation in majour economies

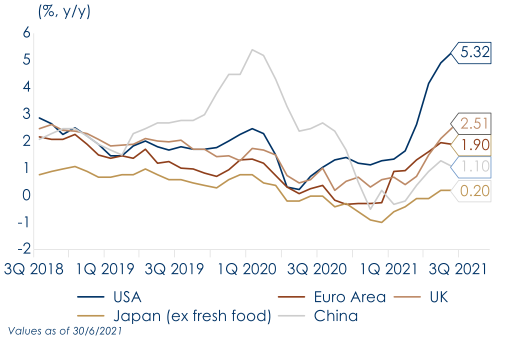


Fig. 11
Producer Inflation in major economies

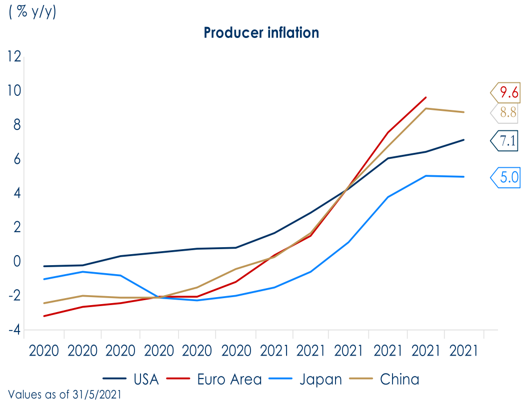
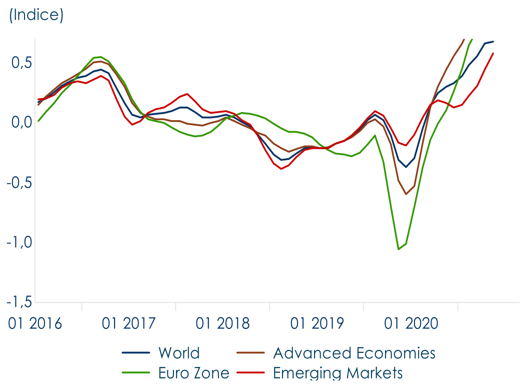


Fig. 12
Business cycle: inflation indicator momentum



FOCUS OF THE MONTH - 1
GLOBAL INFLATION

- **Headline CPI inflation reached its highest level since January 2012** on the back of reopening of several economies after Covid-19 lockdowns.

- **The key drivers of current inflation flare-up are mainly linked to three specific factors**: first bottlenecks in global supply chains, secondly, base effects generated by comparing year over year data. Finally generalized increases in base costs.

  - **Base effects** from the comparison with the months of 2020 when prices and, in particular, energy prices collapsed due to the pandemic;

  - While reopening economies generate a strong pick-up in business activity and spending surge, **supply chains are under stress**. Bottlenecks in transportation, logistic networks and more broadly in production supply chains generated by the closure of some Chinese ports due to the COVID-19 pandemic and shortages of deliveries from Asia are negatively affecting trade, limiting potential growth rebounds.

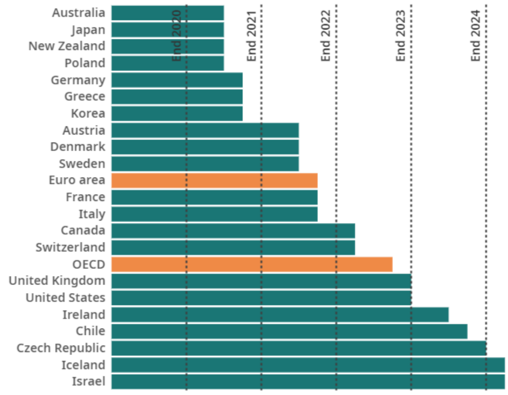
  - Increased transport costs, **raw material increases starting from agro-commodities up to base metals as well as precious metals**, which are a main inputs for the High-tech and the Semiconductors Industry.

- **Growth in the money supply has started to slow down but remains at very high levels** (about twice the average rate of the last two decades). This fast pace remains, a risk to the inflation scenario and fuels concerns that the recent rise in inflation in advanced economies could persist beyond forecasted base effects.

- Nonetheless, advanced growth indicators signal the beginning of a period of normalization in the pace of trade and industrial activity. **However, we believe this is just a transitory phase from the hyper-growth rate generated by the "reopening phase" to a stabilization phase**, which should be sustained at a high rate.

Fig. 13

Recovery of the labour market



"Recovery to pre-pandemic level" refers to a sustained increase in employment level above its Q4 2019 level. • Source: OECD (2021), OECD Employment Outlook 2021

Fig. 14

Years...to be back on track

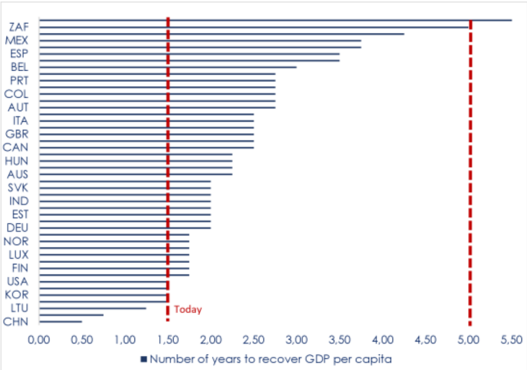
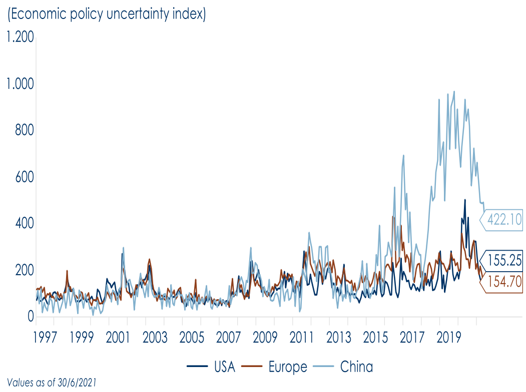


Fig. 15

Economic policy uncertainty index



FOCUS OF THE MONTH - 2/2 GROWTH CORNERSTONES

- **Labour market recovery**: An economic recovery based on the manufacturing sector: Manufacturing Up to 21 million jobs were saved during the COVID-19 pandemic thanks to unprecedented expansion of income maintenance and support schemes. However, even though economic growth is expected to accelerate as vaccination campaigns continue and restrictions are lifted, unemployment remains high. OECD expects the job market recovery to lag behind the economic recovery and reaching pre-pandemic employment rates could take several years

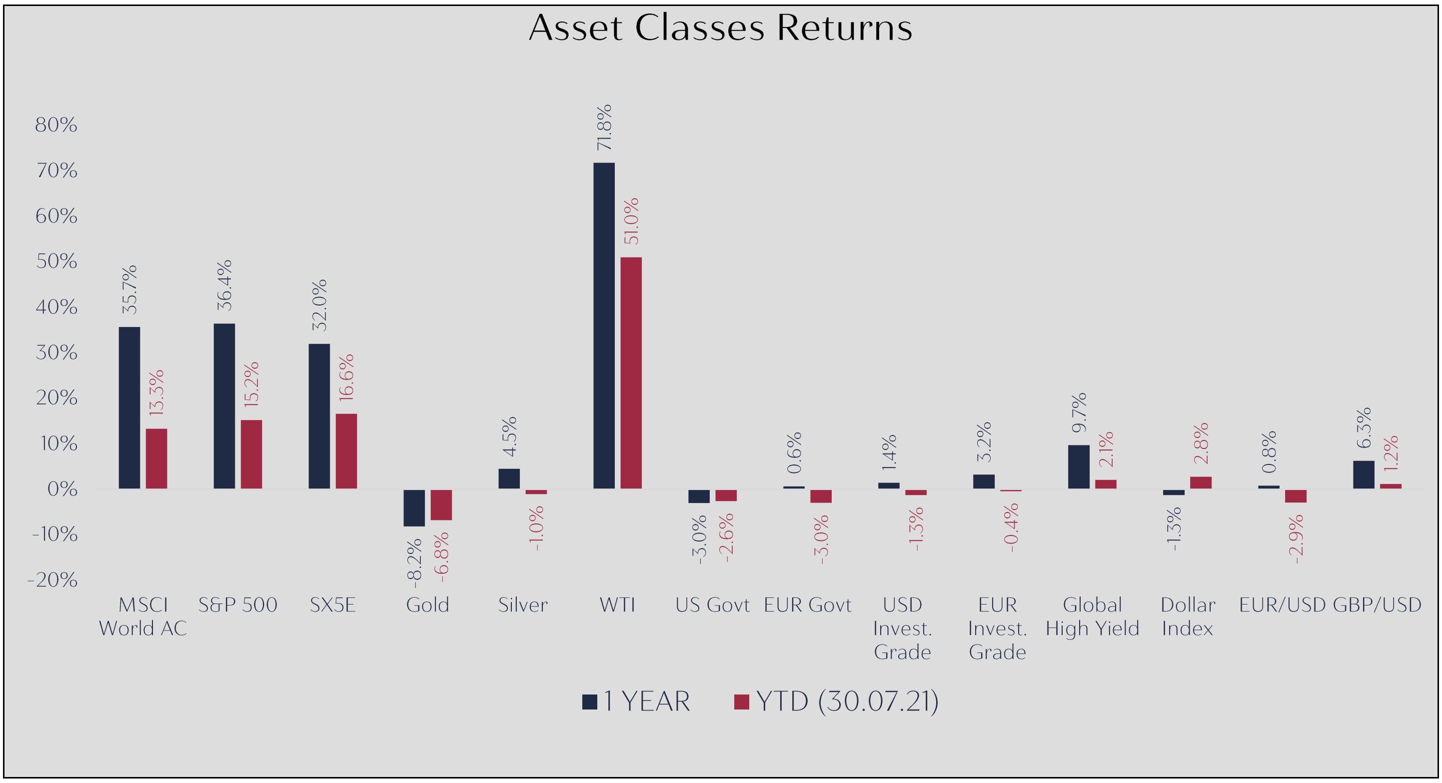
- **Return to growth ...asynchronous**: Economic growth is sharply accelerating. However, the recovery of economic activity remains asynchronous and uneven, strongly affected by the effectiveness of vaccination programs and fiscal policies. The timing of recovery differs from country to country. Chart 14 shows the number of years each country needs to recover pre-pandemic GDP growth rates.

- **Political uncertainty is easing**. Major international disputes, especially the US-China trade dispute was temporary abandoned during the Covid-19 crisis. The synchronized global response from both a political and monetary counterparties helped to reduce uncertainty for businesses and consumers. The Delta variant is weighing on containment measures and stringency indexes are not yet back to pre-pandemic levels. The surprised reaction to inflation continues to grow while the surprise about growth stabilizes. The current situation could persist as long as the Delta variant will be considered a major risk from the OMS.

- **Vaccination rates count**: The French government is taking a more aggressive stance to counter vaccine skepticism. In fact, President Macron announced further measures to slow the spread of the Delta variant, which is significantly more contagious than previous strains, announcing plans to make vaccines mandatory for healthcare workers.

MARKET UPDATE

Economic growth is sharply accelerating. In 2020, the restrictions in response to the spread of COVID constituted the most significant limitation on economic activity. The success of the vaccination campaigns, supported by broadly accommodative and coordinated monetary and fiscal policies implemented since the start of the pandemic, has made growth strong on both sides of the Atlantic, as well as in China and Asian countries connected through the supply chain. Following the progress made towards resolving the public health crisis and the reopening and restart of entire sectors that were heavily penalized over the past year, we expect to witness an increasingly consolidated and geographically widespread recovery, sustained by household consumption and business investments, as households and businesses begin spending the precautionary savings that they had accumulated during the long period of uncertainty.



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	↑
ECONOMIC	**World:** US-China relations are likely to remain tense, although the Biden election could lead to a multilateralism return.	HIGH	MEDIUM	=
ECONOMIC	**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	↑
ECONOMIC	**World:** if supply-side bottlenecks, i.e. shortages not only in production chains but also in the labour market, were to persist, inflation could increase wothout economic growth, putting margins under pressure. Markets could become more volatile in this context.	HIGH	MEDIUM	↑
ECONOMIC	**United States:** Some US indicators already point to a strengthening of the labour market. If the forthcoming employment reports show this trend, both real and nominal yields could rise and government bond yield curve could steepen	HIGH	MEDIUM	↓
ECONOMIC	**United States:** Fed should clearly communicate their outlook for monetary policy and ensure that inflation fears do not trigger rapid tightening of financial conditions. Fed should in addtiotion avoid premature thigntening of its moentary policy.	HIGH	LOW	↑
ECONOMIC	**Eurozone:** Eurozone countries economic asymmetry is increasing. COVID_19 has affected euro area countries asymmetrically, as they have been able to implement different fiscal measures and, above all, will have to deal with 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	=

(*) With respect to the previous month evauluation

POSITIONING

In this scenario:

- we continue to take a **negative view of core European government bonds**, while we expect US T-bill yields to show a moderate upward trend after the decline in the second quarter of the year driven by the real and term premium component. We therefore take a **neutral-negative tactical view of US bonds**, while we look favorably on those with a higher carry, namely emerging market debt.
- In the **IG corporate bond segment**, the level and valuations of spreads make the asset class vulnerable to changes in rates and could be affected by movements and volatility, which overall remains limited. Monetary policy support continues to be a determining factor for the scenario and we are therefore neutral.
- we are maintaining our **positive view of equities**. Our view on the asset class remains constructive in the medium/long term with some caution for the current quarter: yields in the first six months of the year, negative seasonality and expectations of forthcoming macroeconomic data adjusted for the base effect and Fed decisions could lead to purchase opportunities.
- we continue to favor emerging market equities and the Chinese stock market in particular, assuming the country's higher relative growth. The Euro Area should 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