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MACROECONOMIC FORECASTS 2021-2022

ECONOMIC RESEARCH TEAM'S PUBLICATION

An uneven recovery

US "outperformance"

Continuing restrictions in Asia

EDMOND DE ROTHSCHILD, BOLD BUILDERS OF THE FUTURE.

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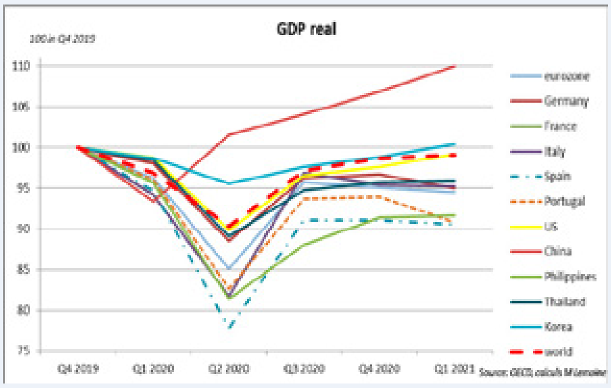

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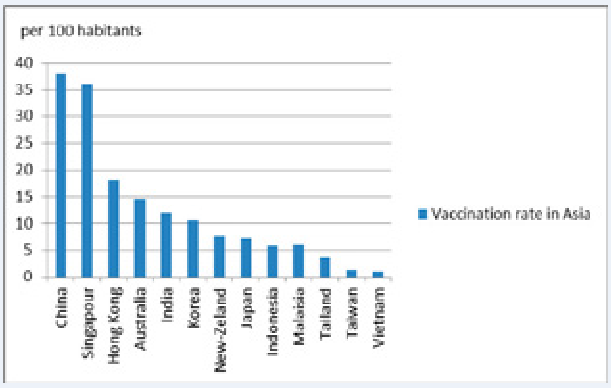

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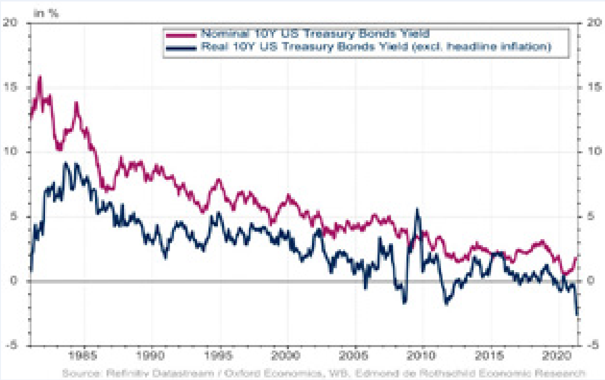

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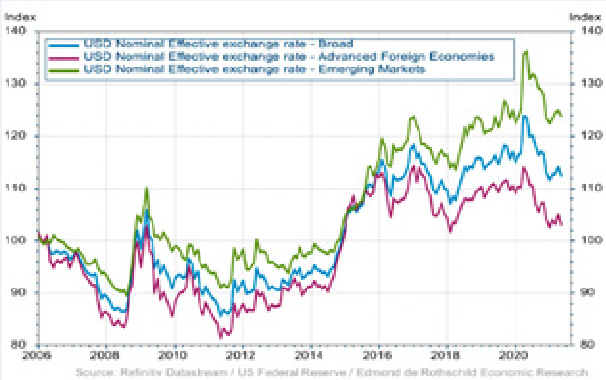

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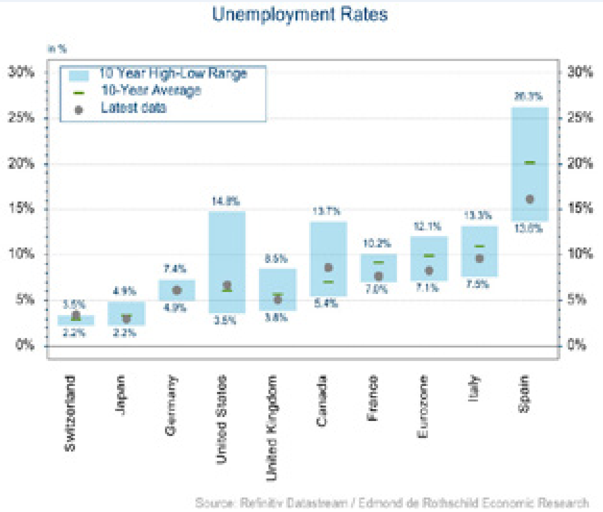

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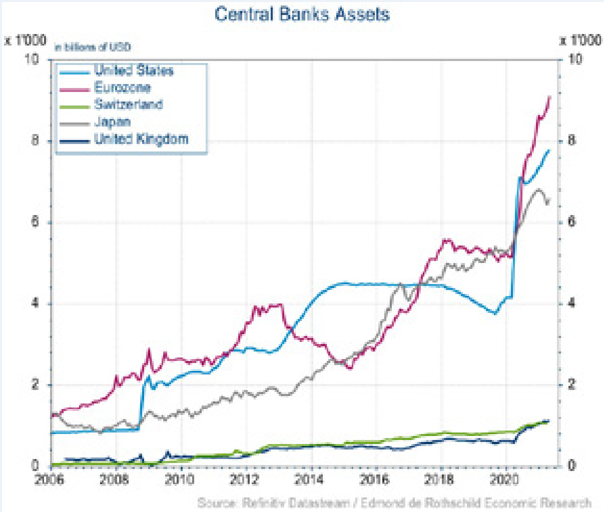

OUR ECONOMIC AND FINANCIAL SCENARIO: **DIVERGENCES**

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Asia has stalled due to the lack of a collective policy on immunity

The US has successfully "rebased" its economy

The Europeans are losing their monetary autonomy

In developed countries, economic activity is directly correlated to the lifting of the health restrictions, which in turn are influenced by the vaccination rate. Consumer services and leisure activities have therefore restarted. In manufacturing sectors, production has exceeded pre-crisis levels. Trade in goods is 25% above its low point in May 2021 and 5% above its level in the first half of 2019. Thanks to the support provided to consumption, via financial grants in the US and short-time working measures in the eurozone, household demand remained strong and was distorted in favour of goods. The increase in the number of people who have been vaccinated will support the consumption of services and reduce the need for remote working equipment. The pressure on commodity prices is therefore likely to ease. **The momentum of the recovery in the eurozone is lagging behind the United States.** Indeed, the implementation of massive stimulus plans since the start of the pandemic in the US should generate growth of 6.6% in 2021 according to our forecasts, before slowing to 4.6% in 2022. With the normalisation of consumption as assistance measures come to an end and with the catch-up effect, GDP growth will decelerate, while remaining above its potential under the effect of the "infrastructure" plan. Eurozone growth will benefit from the unlocking of the funds of the European recovery plan and the lifting of restrictions. It is expected to be stronger in 2022, at 4.9% after 4% in 2021.

In Asia, apart from China and Singapore, the low vaccination rate is weighing on economic momentum, particularly in countries that are highly dependent on tourism. **Growth in the ASEAN countries is therefore likely to continue to be penalised** by travel restrictions in 2021 and be capped at 5.1% in 2021 before reaching 5.8% in 2022, according to our forecasts.

We therefore expect a slight slowdown in global growth in 2022 to 4.9%, after 5.2% in 2021, based on the assumption of a commitment by the G20 to target collective immunity. The rise in commodity prices is likely to erode purchasing power, but it partially stems from the gradual return of activity and inventory rebuilding. Inflation should therefore slow in 2022. At the same time, the return of low-skilled labour to the jobs market is set to curb the rise in the average wage. Moreover, the emerging central banks will continue to tighten their monetary policies. The Federal Reserve could also raise its key rate at the end of 2022 after reducing its asset purchases, which currently stand at $120 billion per month. Lastly, the slow pace of the vaccinations in many emerging countries is pushing back the reopening of borders and the return to normal demand for tourist services. However, the US is winning its "inflation rebasing" bet. Inflation expectations reached their highest point since May 2013, but real interest rates fell sharply. For example, the US 10-year inflation-adjusted sovereign rate has not been so deeply negative since 1980. The European Central Bank has its back to the wall and will have to announce a change in its inflation target this autumn. A better understanding of the economic impact of epidemics will result in greater volatility in the fixed income markets. Moreover, the large differences in increases in COVID debt between countries will lead to divergent trends in sovereign ratings, as demonstrated by the econometric work carried out on the effects of influenza epidemics.

In order to attain a more uniform recovery of the global economy, the G20 will have to commit to seeking collective immunity. The position of the European Union is untenable. It wants to control and decide on the vaccine doses that will be sent to the poorest countries via the Covax system it has helped to create. Meanwhile, the varying positions in the cycle and the differing economic policy responses of heads of State and governments have created uncertainty, which could increase the risk premium in the second half of 2021.

SEEKING COLLECTIVE IMMUNITY

The conclusions of studies on the impact of influenza epidemics are clear. The main channel of transmission of a health shock to the economy results from avoidance behaviour and "social distancing" measures. The second is that of direct costs (medical treatment), and indirect costs (decline in production linked to absenteeism), with the latter costs being higher than the first. The third channel comes from compensation and cascade effects such as the slowdown in international trade or the drop in tourism. In addition to the time aspect, two variables characterise influenza epidemics. The first is the "attack rate", which is the proportion of the population that becomes infected. The second is the mortality rate, i.e. the number of deaths caused by the disease. The value of these two variables varies over time, according to the type of epidemic, but also in space.

The aim of the vaccines is to reduce the attack and mortality rates of COVID-19 and therefore the economic impact of the pandemic. However, targeting collective immunity, which requires a vaccination rate of 70% to 80% depending on the source, has not found a consensus within the G20, which accounts for 85% of the world's population and two-thirds of global growth. In Asia, for example, where vaccination rates are low, only Singapore has announced that it is pursuing a collective immunity target. Korea and Japan are in the process of following suit.

As a result, the scale of the global recovery remains subject to the resurgence of the epidemic. The US stimulus plans, the low degree of openness of the US and its low dependence on international tourism make this economy one of the least vulnerable to new restrictions in the rest of the world. Southern eurozone countries are more dependent on international health trends. Most Southeast Asian countries are particularly affected by this uncertainty, particularly the main tourism countries such as the Philippines, Malaysia and Thailand. **The lack of commitment from heads of state and governments with respect to collective immunity is a setback for a uniform recovery in the global economy.**

ASIA IS FALLING BEHIND

Asia's management of the pandemic served as a model in 2020. The ability of the Asian countries to curb COVID-19 and limit its impact on the economy made them the first to reopen in 2020. As of the second quarter of 2020, China's GDP had exceeded its level at the end of 2019. Korea returned to its end-2019 GDP level at the beginning of this year and Vietnam did not fall into recession last year. Vietnam benefited from the increase in US demand resulting from the tensions with China. However, Asian countries vary greatly due to the structure of their economies. The resurgence of the virus and the low vaccination rate, except in China and Singapore, are weighing on the economies the hardest hit by the pandemic. The Philippines, Malaysia, Indonesia and Thailand still have much lower GDP levels than at the end of 2019. Moreover, the fiscal support, not comparable to that of developed countries, will dry up after the additional measures adopted in early 2021 by China, India, South Korea, Singapore, Hong Kong, Malaysia and Japan. At the same time, emerging central banks will have to raise their key rates in order to avoid capital outflows.

Strong demand for industrial goods especially benefited China and Taiwan, where production levels exceeded pre-crisis levels by nearly 20%, as well as Korea. The redirection of household consumption in developed countries to hotels, restaurants, transport and cultural activities, and the reduced need for office equipment made necessary by the pandemic, could weigh on exports of goods, but the restart of activity in developed countries will support demand for Asian exports. In addition, demand for household goods is correlated to real estate demand, boosted by oversaving and the historical fall in real interest rates, particularly in the US. As a result, as long as the Southeast Asian economies remain under Covid restrictions, the lack of uniformity in the recovery is too great in Asia for it to be solid and erase the impacts of the pandemic at the level of GDP per capita.

US "OUTPERFORMANCE"

While many G20 countries have introduced measures to avoid a liquidity crisis, a common goal of Western countries has been to preserve household income and roll out the vaccines to obtain collective immunity. The United States is poised to win its bet, as in early 2021 its GDP level had virtually returned to its end-2019 level. According to our calculation, the output gap should be positive as of early 2022. This means that potential GDP has not had time to be affected by the crisis. Its continued strong growth limits the risk of persistent inflationary pressure. The growth in investment in early 2021 corroborates this analysis. Household consumption has returned to its level at the end of 2019; consumption of goods is 13% higher and that of services still 5% lower. According to our models, **the Infrastructure Plan will limit the depressive effect of the end of the financial assistance provided to households in 2020 and early 2021, generating 0.2% point of GDP at the end of 2022.** Moreover, the recovery in employment levels will support wage growth. Lastly, the improvement in the health situation should lead to a fall in the savings rate. The public deficit is expected to fall back to 5% in 2023 after reaching 15% in 2021 thanks to the pressure put on the US economy and its "rebasing". The tightening of credit conditions is likely to be controlled by the bulk of corporate COVID debt being kept off banks' balance sheets.

TEMPORARY AND PERMANENT INFLATION

The recovery in commodities prices began with metals and oil, followed by agricultural products. It has a knock-on effect on producer and consumer prices and raises the social risk in developing countries affected by the pandemic and the collapse of tourism. This increase in prices is the result of renewed demand, with some governments wanting to build inventories, while others want to block commodity exports. These factors are cyclical. However, for some commodities the rise stems from the acceleration in the energy transition or environment-related political decisions, such as in China. This rise in the prices of certain raw materials, such as lithium, needed for the production of electric batteries, is structural and will lead to a change in the relative prices of commodities. Xi Jinping has announced a reduction in CO2 emissions of at least 65% compared to 2005 levels by 2030, although the 14th Five-Year Plan does not specify how this will be achieved by the country.

In addition, the Federal Reserve's paradigm shift to average inflation targeting has implications that I think are currently underestimated by investors. As long as it is credible, this change will generate a rise in inflation in the medium term and a decline in real rates in the short term. The Fed has forced other central banks, especially the European Central Bank (ECB) to react to its position. I continue to anticipate a change in the ECB's monetary policy objective this autumn, while the Federal Reserve may have already reduced its asset purchases[1].

This "rebasing" of inflation could lead to an acceleration in wages in the eurozone given the high proportion of indexed wages. However, the return to the labour market of low-skilled employees will limit the growth in the average median wage and curb the pricing power of companies, especially in Europe and China, where the rapid ageing of the population is weighing on demand. Moreover, we do not anticipate the savings rate falling to its pre-crisis level before the end of 2022 and "oversaving" could continue to support housing demand. The ECB will have to contend with the stronger power of national financial stability authorities, which control the implementation of macro-prudential measures.

[1] : For a full analysis of the inflationary risks resulting from the central banks' balance sheet expansion policy, see Mathilde Lemoine, "The problem is growth, not inflation" May 2021

The People's Bank of China is in a unique position as its balance sheet has not increased and it has already tightened its monetary policy. It favours an interest rate policy rather than liquidity measures to keep within a range of rates. The ongoing obsession of the government and the Communist Party is to ensure financial stability in order to continue capital account liberalisation. The rise in total debt in 2020 from 25% to 280% of GDP is being closely monitored. At the Politburo meeting of 30 April 2021, it was announced that the management of financial and budgetary risks would be the responsibility of the local Communist Party. This tightens the correlation between the credit risk of State-owned companies and the fiscal situation of the regions. Moreover, the People's Bank of China continues to regard the exchange rate as a macroeconomic "automatic stabiliser" and continues to increase the flexibility of the RMB, facilitating capital account liberalisation. This is coordinated with interest rates, the reform of the exchange rate regime and the internationalisation of the RMB. Demand for Chinese currency is therefore likely to increase structurally, but the recent appreciation of the RMB against all currencies and in particular against the dollar has notably resulted from statements by Liu Guoqiang suggesting that its flexibility would increase significantly. We therefore continue to anticipate an exchange rate between the dollar and the renminbi of 6.50 in 2022.

THE REBOUND OF THE EUROZONE LIMITED BY FUNDAMENTALS

GDP in the eurozone, which previously faced an additional crisis in the form of its sovereign debt crisis, fell more sharply during the Covid-19 pandemic than in the United States and some Asian countries. The implementation of the Next Generation EU recovery plan is expected to generate an additional 0.2 points of growth by the end of 2022. It contributes to supporting public investment in the eurozone, which in 2020 was 10% below its level in 2009. However, the pandemic has simply highlighted the weakness of potential growth in the eurozone and the ageing of its population. Given these characteristics, the challenge of initial and continuing education is even more fundamental, but unfortunately does not constitute a component of the stimulus plans.

The economic situation in the eurozone is therefore based on public and private investment and the European Central Bank's ability to maintain accommodative credit conditions while inflation is structurally lower than in the United States. In addition, ageing and fiscal uncertainty have slowed the return of the savings rate to its pre-crisis level. Moreover, the European Commission will compete with the Member States, as it has announced a €125 billion issue in 2021 to finance the Next Generation EU plan. The high disparity among eurozone countries in terms of the increase in public debt makes the southern countries more vulnerable. Debt as a percentage of GDP of Greece, Spain, Italy and France increased by 25.1%, 24.5%, 21.2% and 18.2%, respectively, between Q4 2019 and 2020. This ratio increased by 10% for Germany, 6% for the Netherlands and 3% for Luxembourg, with these three countries having a government surplus, unlike Spain, Italy and France.

MACROECONOMIC DIVERGENCES

The shape, pace and conditions of the recovery are in line with the findings of flu epidemic models. Its lack of uniformity stands out. Indeed, the recovery differs:

› among the eurozone countries

› between the US and the eurozone

› between the Asian manufacturing and tourism countries

› between leisure services and industry

› depending on the size and structure of the stimulus plans

› depending on the extent and speed of implementation of the stimulus plans

› depending on the vaccination rate

› depending on the confidence in the ability of governments to stem the pandemic

› depending on the qualifications of workers and the proportion of workers in sectors heavily affected by social distancing

› depending on the current account balance.

These variable divergences do not call into question the correlation between the vaccination rate and the end of the crisis, but weigh on the momentum of global growth, which could take longer than expected to return to the level of GDP it should have reached had there been no pandemic. Moreover, by redefining its inflation objective through average inflation targeting, the Federal Reserve is forcing the major central banks to react to its position. They have lost part of their monetary autonomy that the coordination of monetary policy orientations had conferred.

In light of these divergences, only strengthened global coordination is likely to limit volatility and the rise in the risk premium. The first initiative could be a G20 commitment in favour of collective immunity. **The second** would be a coordination of monetary policies on exiting the crisis. The Federal Reserve used its position to show that it did not believe in the virtues of negative nominal interest rates. But the eurozone is mired in this strategy and the economic lag of some emerging countries will lead the central banks of these countries to tighten their monetary policies. The control of the pandemic could highlight the disorderly nature of monetary strategies and the financial instability it generates. At the same time, the continuation of China's gradual capital account liberalisation strategy will increase the volatility of exchange rates.

More structurally, I continue to believe that the COVID-19 pandemic will have a lasting impact on labour supply, as found by the impact models for epidemics. Beyond the disease itself, its direct consequences on the development of other pathologies and on childcare increase absenteeism. But the fear of the virus has generated a high level of stress, which also affects health. Once the effects of the lockdown have been erased, the result is a lasting retraction in economic activity. In the longer term, the challenges of normal school attendance brought on by the epidemic have an impact on skill levels and, therefore, on trend growth in GDP per capita. In addition, downwards pressure on average wages owing to the increase in the unemployment rate reduces the incentive to study, as demonstrated by microeconomic research on human capital. Furthermore, employability is no longer at the heart of companies' concerns, as demonstrated by the most recent surveys.

In the short term, the decline in labour supply and higher production costs explained 78% of the decline in US GDP and 87% of the fall in the eurozone's GDP. In the longer term, thanks to a long-term growth model, we can see an impact of the fall in the labour supply of 0.3 percentage points on potential growth in the eurozone, which is considerable given its low level (1.3% according to our calculations). Countries that do not implement policies to avoid a deterioration in the quality of the labour supply will see their capacity to repay public debt weaken. For the time being, Europe is lagging behind in this regard compared with the US and China, which have made education and qualification of the workforce a focus of their economic programmes.

OUR FORECASTS
2021 - 2022

Our GDP growth forecasts

GDP growth in volume (%)	2016	2017	2018	2019	2020	2021						2022			
						Q1	Q2f	Q3f	Q4f	2021f	C*	Q1f	Q2f	2022f	C*
World	**3.4**	**3.9**	**3.8**	**3**	**-3.4**	-	-	-	-	**5.2**	*5.2*	-	-	**4.8**	*3.6*
United States	**1.7**	**2.4**	**2.9**	**2.3**	**-3.5**	0.4	11.9	6.9	7.3	**6.6**	*6.5*	6.1	5.7	**4.6**	*4.0*
Eurozone	**1.9**	**2.6**	**1.9**	**1.3**	**-6.7**	-1.8	12.7	1.6	3.7	**4.0**	*4.1*	5.5	5.1	**4.9**	*4.2*
Germany	**2.2**	**2.6**	**1.3**	**0.6**	**-5.1**	-3.0	9.6	2.2	3.0	**3.0**	*3.3*	6.0	5.1	**5.1**	*4.1*
France	**1.1**	**2.3**	**1.8**	**1.8**	**-8.0**	1.2	17.9	0.7	3.2	**5.8**	*5.6*	4.1	4.3	**4.0**	*4.0*
Italy	**1.3**	**1.7**	**0.8**	**0.3**	**-8.9**	-0.9	14.8	0.6	3.7	**4.5**	*4.4*	5.1	4.5	**4.2**	*4.0*
Spain	**3.0**	**2.9**	**2.4**	**2.0**	**-10.8**	-4.2	18.3	2.8	4.4	**5.3**	*5.8*	6.2	5.8	**5.4**	*5.5*
Portugal	**2.0**	**3.5**	**2.8**	**2.5**	**-7.6**	-5.4	14.2	3.2	4.2	**4.1**	*4.3*	9.0	6.0	**5.8**	*5.2*
Europe ex Eurozone	**1.7**	**1.9**	**1.8**	**1.5**	**-7.3**	-	-	-	-	**4.8**	*4.7*	-	-	**3.8**	*3.2*
United Kingdom	**1.7**	**1.7**	**1.2**	**1.4**	**-9.8**	-6.1	21.0	5.8	5.3	**6.5**	*6.3*	7.3	3.6	**4.3**	*5.4*
Switzerland	**2.0**	**1.7**	**3.0**	**1.1**	**-2.7**	-0.5	7.6	1.6	2.1	**2.7**	*3.4*	3.8	2.8	**2.5**	*2.6*
Japan	**0.8**	**1.7**	**0.6**	**0.0**	**-4.7**	-1.6	8.3	3.0	2.0	**2.9**	*2.8*	2.7	1.9	**1.6**	*1.8*
Emerging Markets	**4.4**	**4.9**	**4.8**	**3.9**	**-1.3**	-	-	-	-	**4.9**	*5.3*	-	-	**5.2**	*5.0*
China	**6.8**	**6.9**	**6.7**	**6.0**	**2.3**	18.3	6.8	6.1	5.3	**9.1**	*8.5*	6.1	5.6	**5.8**	*5.5*
ASEAN	**4.8**	**5.3**	**5.0**	**4.2**	**-4.6**	-	-	-	-	**5.1**	*4.8*	-	-	**5.8**	*4.8*
Brazil	**-3.3**	**1.3**	**1.8**	**1.4**	**-4.1**	1.0	8.7	2.7	2.3	**3.7**	*3.4*	2.5	1.6	**2.3**	*2.4*

*** Consensus**

Our inflation forecasts

Consumer price index (%)	2016	2017	2018	2019	2020	2021						2022			
						Q1	Q2f	Q3f	Q4f	2021f	C*	Q1f	Q2f	2022f	C*
World	**2.8**	**2.8**	**3.2**	**3.1**	**2.4**	-	-	-	-	**2.9**	*2.6*	-	-	**2.7**	*2.8*
United States	**1.3**	**2.1**	**2.4**	**1.8**	**1.3**	1.9	3.9	2.8	2.8	**2.9**	*2.9*	2.5	2.3	**2.3**	*2.3*
Eurozone	**0.2**	**1.5**	**1.8**	**1.2**	**0.3**	1.1	2.0	2.4	2.6	**2.0**	*1.7*	1.9	1.6	**1.6**	*1.3*
Germany	**0.4**	**1.7**	**1.9**	**1.4**	**0.4**	1.7	2.4	2.9	3.3	**2.6**	*2.4*	1.8	1.5	**1.7**	*1.4*
France	**0.3**	**1.2**	**2.1**	**1.3**	**0.5**	1.0	1.8	2.1	1.9	**1.7**	*1.4*	1.5	1.5	**1.4**	*1.2*
Italy	**-0.1**	**1.3**	**1.2**	**0.6**	**-0.1**	0.8	1.4	1.6	1.7	**1.4**	*1.2*	1.1	1.0	**1.1**	*0.9*
Spain	**-0.3**	**2.0**	**1.7**	**0.8**	**-0.3**	0.5	2.4	2.5	2.4	**2.0**	*1.4*	1.6	1.3	**1.2**	*1.2*
Portugal	**0.6**	**1.5**	**1.2**	**0.3**	**-0.1**	0.2	1.2	0.8	0.9	**0.8**	*1.2*	0.4	0.6	**0.6**	*0.8*
Europe ex Eurozone	**0.8**	**2.2**	**2.3**	**1.6**	**0.7**	-	-	-	-	**1.4**	*1.0*	-	-	**1.5**	*1.4*
United Kingdom	**0.7**	**2.7**	**2.5**	**1.8**	**0.8**	0.6	1.5	1.8	2.7	**1.7**	*1.6*	2.1	1.9	**2.2**	*1.8*
Switzerland	**-0.4**	**0.5**	**0.9**	**0.3**	**-0.7**	-0.4	0.6	0.4	0.6	**0.3**	*0.3*	0.5	0.4	**0.4**	*0.5*
Japan	**-0.1**	**0.5**	**1.0**	**0.5**	**0.0**	-0.4	0.5	0.2	0.3	**0.2**	*0.1*	0.4	0.5	**0.3**	*0.6*
Emerging Markets	**4.3**	**3.6**	**4.0**	**4.2**	**3.7**	-	-	-	-	**3.5**	*3.5*	-	-	**3.1**	*3.4*
China	**2.0**	**1.6**	**2.1**	**2.9**	**2.5**	0.0	1.6	2.0	0.9	**1.1**	*1.6*	1.5	2.3	**2.2**	*2.3*
ASEAN	**1.9**	**2.7**	**2.5**	**1.9**	**1.1**	-	-	-	-	**2.5**	*2.1*	-	-	**2.3**	*2.2*
Brazil	**8.8**	**3.5**	**3.7**	**3.8**	**3.2**	5.3	6.3	5.3	5.1	**5.5**	*5.2*	4.5	4.1	**4.0**	*3.8*

*** Consensus | Our underlying oil assumption : $69.5 dollars a barrel at the end of 2021 and $73 dollars average in 2022**

Our monetary policy and yield forecasts

Interest rates (%)**	2017	2018	2019	2020	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	2021f	2022 Q1f	2022 Q2f	2022f
United States												
Benchmark rate	**1.13**	**1.96**	**2.25**	**0.50**	0.25	0.25	0.25	0.25	**0.25**	0.25	0.25	**0.30**
2-year Schatz yield	**1.38**	**2.49**	**1.98**	**0.43**	0.12	0.16	0.20	0.25	**0.18**	0.30	0.45	**1.15**
10-year Bund yield	**2.34**	**2.88**	**2.16**	**0.90**	1.15	1.63	1.70	1.80	**1.57**	1.85	1.95	**2.20**
Eurozone												
Deposit rate	**-0.40**	**-0.40**	**-0.43**	**-0.50**	-0.50	-0.50	-0.50	-0.50	**-0.50**	-0.50	-0.50	**-0.50**
2-year Schatz yield	**-0.74**	**-0.62**	**-0.67**	**-0.70**	-0.70	-0.69	-0.68	-0.67	**-0.68**	-0.67	-0.67	**-0.65**
10-year Bund yield	**0.37**	**0.44**	**-0.22**	**-0.48**	-0.44	-0.22	-0.25	-0.15	**-0.27**	-0.13	-0.12	**-0.05**
French gov. bond 2-year	**-0.50**	**-0.45**	**-0.60**	**-0.61**	-0.66	-0.64	-0.63	-0.60	**-0.63**	-0.60	-0.60	**-0.45**
French gov. bond 10-year	**0.78**	**0.72**	**0.11**	**-0.14**	-0.18	0.10	0.14	0.15	**0.05**	0.18	0.20	**0.40**
United Kingdom												
Benchmark rate	**0.29**	**0.60**	**0.51**	**0.21**	0.10	0.10	0.15	0.20	**0.14**	0.20	0.25	**0.30**
2-year Schatz yield	**0.22**	**0.71**	**0.60**	**0.07**	0.02	0.06	0.10	0.15	**0.08**	0.20	0.35	**0.60**
10-year Bund yield	**1.19**	**1.38**	**0.87**	**0.29**	0.57	0.84	0.90	1.10	**0.85**	1.15	1.30	**1.35**
Switzerland												
Benchmark rate	**-0.75**	**-0.75**	**-0.75**	**-0.75**	-0.75	-0.75	-0.75	-0.75	**-0.75**	-0.75	-0.75	**-0.75**
2-year Schatz yield	**-0.78**	**-0.71**	**-0.79**	**-0.74**	-0.77	-0.77	-0.75	-0.70	**-0.75**	-0.70	-0.68	**-0.65**
10-year Bund yield	**-0.12**	**-0.02**	**-0.57**	**-0.51**	-0.40	-0.25	-0.15	-0.09	**-0.22**	-0.09	-0.06	**-0.05**
Japan												
Benchmark rate	**-0.10**	**-0.10**	**-0.10**	**-0.10**	-0.10	-0.10	-0.10	-0.10	**-0.10**	-0.10	-0.10	**-0.10**
2-year Schatz yield	**-0.17**	**-0.13**	**-0.20**	**-0.15**	-0.13	-0.13	-0.11	-0.10	**-0.12**	-0.10	-0.09	**-0.10**
10-year Bund yield	**0.05**	**0.07**	**-0.10**	**0.00**	0.07	0.08	0.07	0.06	**0.07**	0.08	0.0.8	**0.10**
Emerging Markets												
China												
1-year lending rate	**3.17**	**3.28**	**3.30**	**3.00**	2.95	2.95	2.95	2.95	**2.95**	2.98	3.00	**3.20**
Reserve requirement ratio***	**17.00**	**15.85**	**13.40**	**12.50**	12.50	12.50	12.50	12.50	**12.50**	13.00	13.00	**14.00**
Brazil												
Benchmark rate Brazil	**10.17**	**6.58**	**6.04**	**2.89**	2.11	4.50	6.00	6.50	**4.80**	6.75	7.00	**7.00**

*Consensus | **Sovereign bond yields shown are averages for the annual periods and period-end figures for the quarterly periods. ***major banks

Our FX forecasts

Exchange rate**	2017	2018	2019	2020	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	2021f	2022 Q1f	2022 Q2f	2022f
Dollar												
EUR/USD	**1.13**	**1.18**	**1.12**	**1.14**	1.21	1.21	1.22	1.20	**1.21**	1.19	1.18	**1.18**
USD/JPY	**112**	**110**	**109**	**107**	106	109	109	108	**108**	109	109	**110**
GBP/USD	**1.29**	**1.34**	**1.28**	**1.28**	1.38	1.40	1.42	1.40	**1.40**	1.39	1.38	**1.36**
USD/CHF	**0.98**	**0.98**	**0.99**	**0.94**	0.90	0.91	0.95	0.96	**0.93**	0.96	0.97	**0.98**
USD/CNY	**6.76**	**6.62**	**6.91**	**6.90**	6.48	6.48	6.50	6.50	**6.49**	6.55	6.50	**6.50**
USD/BRL	**3.19**	**3.65**	**3.94**	**5.15**	5.47	5.43	5.32	5.30	**5.38**	5.25	5.20	**5.23**
Euro												
EUR/GBP	**0.88**	**0.88**	**0.88**	**0.89**	0.87	0.86	0.83	0.84	**0.85**	0.86	0.86	**0.88**
EUR/CHF	**1.11**	**1.15**	**1.11**	**1.07**	1.09	1.10	1.10	1.11	**1.10**	1.10	1.10	**1.12**

*Consensus | **Period average

THE HEAVYWEIGHTS OF GLOBAL GROWTH

Asia & China

Subdued

Mathilde Lemoine
Group Chief Economist

- **The low vaccination rates in most Asian countries…**
- **… will continue to hamper consumption**
- **Beijing is keeping a close eye on financial stability, but could provide more fiscal support**

Though Asia has managed to curb the spread of the pandemic more effectively than developed countries, the economic recovery is proving sluggish. In the second half of 2020, the continent posted year-on-year GDP growth of 2.7% after shedding 3.2%. It bounced back strongly at the start of 2021, but only a handful of countries, such as China, Taiwan and South Korea, saw their GDP rise above late-2019 levels. The disparities are sizeable.

Household spending has been limited by the introduction of new public health measures in China, Malaysia and Indonesia in particular. Meanwhile, tourism is still suffering from the restrictions on international travel. The most tourist-driven countries, like the Philippines, Malaysia and Thailand (where tourism accounts for 8%, 9% and 22% of GDP in the formal economy) are also those where vaccination rates are the lowest. A resurgence in COVID-19 cases was observed in South-East Asia in the second quarter of 2021, and the countries most dependent on services will likely continue to suffer as a result. According to my calculations, the restrictive measures have knocked 1.8% off GDP in Asia, excluding China. In addition, except in China, South Korea and Japan, households have tended to dip into their savings to cope with financial difficulties. There are therefore no “reserves” for consumption. Furthermore, accelerated inflation due to the rise in food and commodity prices is reducing purchasing power. Finally, the rise in U.S. rates is hindering central banks’ monetary policy. The most vulnerable countries are Thailand and the Philippines. Nevertheless, the buoyancy we expect to see from China and the United States in 2021 and 2022, as well as the recovery in the European economy, will continue to support Asian exports, particularly of goods.

In China, the implementation of the new five-year plan and the support for SMEs and some industries, boosted in April 2021, should lead to accelerated investment and private-sector employment. Competition with the United States over vaccine supplies and regional influence could lead Xi Jinping to further strengthen fiscal stimulus while continuing monetary normalization in order to counter the property bubble. Value-added is 10% higher than its pre-crisis level in the property sector, 3% higher in industry, and 18% lower in commercial services, hotels and restaurants. Goods exports are expected to take over from those linked to COVID-19 which buoyed external trade in 2020. While China and the United States’ objectives of technological independence and world leadership remain the same, the growth of these two countries should continue to support transpacific trade, as will the implementation of the Regional Comprehensive Economic Partnership. In 2020, ASEAN became China’s premier trading partner, ahead of the European Union and the United States.

For this reason, we anticipate accelerated growth in Asia and ASEAN countries in 2022, following a slower-than-anticipated resumption of activity in 2021.

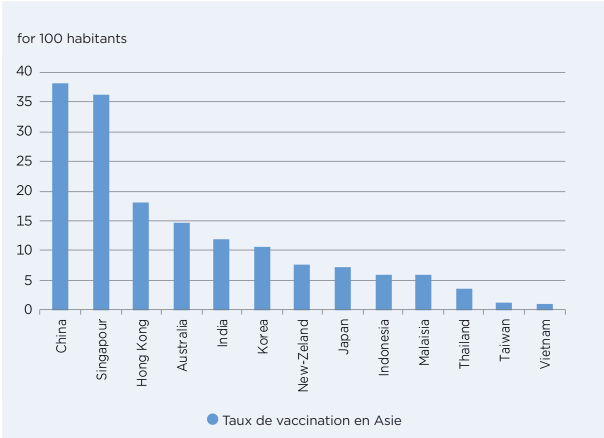
	GDP growth in volume (%)						Consumer price index (%)					
	2017	2018	2019	2020	2021f	2022f	2017	2018	2019	2020	2021f	2022f
Asia	5.7	5.3	4.2	-1.3	7.1	5.8	1.4	1.8	2.2	2.6	2.3	2.0
ASEAN*	5.3	5.0	4.2	-4.6	5.1	5.8	2.7	2.5	1.9	1.1	2.5	2.3
Japan	2.2	0.3	0.7	-4.8	2.6	1.6	0.5	1.0	0.5	0.0	0.2	0.3

CHINA % annual	2017	2018	2019	2020	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	2021f	2022 Q1f	2022 Q2f	2022f
GDP	6.9	6.7	6.0	2.3	18.3	6.8	6.1	5.3	9.1	6.1	5.6	5.8
Retail Sales	10.4	8.9	8.0	-1.1	24.2	13.0	9.0	9.0	13.8	8.0	9.4	9.0
Investments in fixed assets	8.1	6.2	5.7	-4.9	26.8	18.0	6.5	6.1	14.4	8.0	7.6	6.0
Industrial production	6.6	6.1	5.8	5.0	9.8	8.2	6.2	5.7	7.5	6.6	7.5	7.8
Exports	7.6	11.2	0.4	2.0	70.1	34.7	17.0	9.0	32.7	-5.0	7.0	0.5
Inflation	1.6	2.1	2.9	2.5	0.0	1.6	2.0	0.9	1.1	1.5	2.3	2.2
USD/CNY	6.76	6.62	6.91	6.90	6.48	6.48	6.50	6.50	6.49	6.55	6.50	6.50
Prime rates												
› 1-year lending rate	3.17	3.28	3.30	3.00	2.95	2.95	2.95	2.95	2.95	2.98	3.00	3.20
› Reserve requirement ratio	17.00	15.85	13.40	12.50	12.50	12.50	12.50	12.50	12.5	12.50	13.00	13.00

*(*Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam)*

Low vaccination rates are hindering growth

› In the first quarter of 2021, growth in Asia reached 13.9%, after falling by 0.2% in 2020, but these figures hide significant disparities. GDP is 10% higher than its pre-crisis level in China, 4.6% in Taiwan, and 0.5% in South Korea, whereas it is down 8.3% in the Philippines and 4.3% lower in Thailand. Vaccination should allow countries suffering from a lack of tourism to revive their economies. However, the vaccination rate remains low, except in China and Singapore, as infection is quickly spreading again in Malaysia, Thailand, Vietnam and Taiwan. Moreover, only Singapore has asserted its intention to vaccinate its entire population. Restrictions on consumption and tourism should therefore continue to slow Asian growth through 2021, further delaying the efforts of less industrialised countries to catch up.



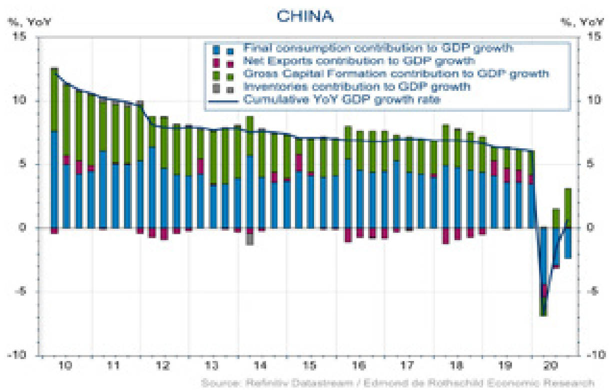
Sources: Refinitiv Datastream, Edmond de Rothschild Economic Research

Acceleration of cyclical inflation

› Inflation has accelerated considerably due to an increase in food and energy prices. In China, the increase in production prices is a result of higher coal and steel prices, in particular. While it is true that the reopening of the West has propped up industrial demand, anti-corruption campaigns in the coal sector and new environmental rules have disrupted the production of commodities. Production prices should therefore return to normal, and their repercussions on consumer prices should be limited by low consumption. The risk in Asia is that public debt could skyrocket, as the stimulus plans in Thailand, Indonesia and Malaysia have involved increased petrol subsidies. Consequently, central banks may have to tighten monetary policy despite weak economic activity.

China, the region's driving force, could strengthen its fiscal support

› Since the second quarter of 2020, Chinese GDP has exceeded its pre-crisis levels. In addition to the base effects that led the authorities to announce growth of 18.3% in the first quarter of 2021 after 2.3% in 2020, investment has made a considerable contribution to boosting economic activity. The contribution of foreign trade has been positive since the second quarter of 2020. Consumption, however, is still sluggish. China's central bank could therefore put a hold on its monetary tightening, especially as most Asian countries are maintaining an accommodating monetary policy. At the end of May 2021, the 10-year government bond saw its lowest yield since September. Furthermore, the current account could increase, exerting downward pressure on the RMB against the dollar. The recent raising of the reserve requirement ratio for foreign currency deposits will reinforce this foreign exchange trend.



United States

Strong growth in 2021 and 2022

Manuel Maleki
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- **Growth could reach 6.6% in 2021 and 4.6% in 2022...**
- **... thanks to a high vaccination rate and investment policies**
- **Inflation is expected to reach 2.9% in 2021 before slowing down**

After a 3.5% drop in GDP in 2020 as anticipated, the US economy should bounce back strongly in 2021 and 2022. Highly accommodating monetary policy, with key rates of between 0 and 0.25% and $120 billion in monthly asset purchases, is complemented by an expansionary fiscal policy. The recovery should get stronger after a solid first quarter in 2021. The two main drivers are the continued opening-up of the US economy thanks to vaccination (at the time of writing, more than 40% of Americans have received at least one dose) and the return of Americans to work, especially in the services sector, in which more than 8 million jobs have been lost. Household income will no longer be supported by transfers but rather by wages. The pandemic led overall wage income to fall by around 10%. Furthermore, the Biden administration plans to spend $6 trillion on three stimulus plans. The American Rescue Plan Act, passed in March 2021, is worth $1.9 trillion, and has resulted in households being issued cheques worth $388 billion, considerably boosting household savings. Excess savings since the beginning of the crisis are thought to total $2.2 trillion, or 10% of GDP. The two other plans are the American Jobs Plan Act, a $2.3 trillion stimulus package focusing on infrastructure, and the American Families Plan, worth $1.8 trillion. The last two plans, not yet voted through, would unfold over ten years.

In 2021, the reopening of the economy and the strong appetite for consumption are expected to boost household spending, which should rise 7.2% before slowing to 4.5% in 2022. The fall in unemployment to 4.7% by the end of 2021 and the increase in earned income should partly offset the depressionary effects of the end of cheques to households. The commodity procurement difficulties and buoyant consumption we are currently seeing, which should last until the end of 2021, should lead to a rise in inflation. After a one-year peak of 4.2% in April, consumer price growth should be slower this year, with supply chains returning to normal and less pronounced base effects. The budget deficit looks set to reach 15% of GDP, before falling to 8.5% of GDP in 2022. Nevertheless, public debt is expected to continue to grow, increasing from 140.5% of GDP in 2021 to 143% in 2022. Tax rises on the most affluent households and on companies, scheduled for 2022 and worth $1.5 trillion over 10 years, would not be sufficient to stabilise debt as a percentage of GDP.

In 2022, according to our models, the infrastructure plan will lead to additional growth of 0.5%. In addition, the fall in unemployment to 4% by the end of 2022 is expected to stimulate household consumption, and particularly that of services, which is still down by $400 billion. The net impact of the families plan and the tax hikes should have a positive effect on GDP growth (+0.1 percentage points).

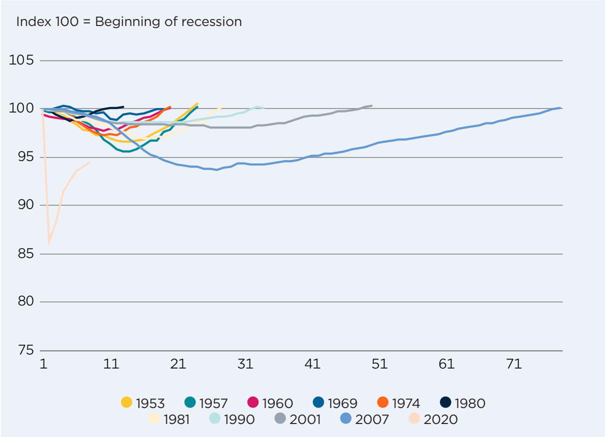
UNITED STATES					2021						2022			
% annual	**2017**	**2018**	**2019**	**2020**	Q1	Q2f	Q3f	Q4f	**2021f**	*C**	Q1f	Q2f	**2022f**	*C**
GDP	**2.4**	**3.0**	**2.2**	**-3.5**	0.4	11.9	6.9	7.3	**6.6**	*6.5*	6.1	5.7	**4.6**	*4.0*
GDP (quarterly %)	**-**	**-**	**-**		1.6	1.4	2.7	1.5		-	0.4	0.9		-
Private consumption	**2.6**	**2.7**	**2.4**	**-3.9**	0.5	13.8	6.5	8.0	**7.2**	*7.5*	5.7	5.2	**4.5**	*4.2*
Public consumption	**0.7**	**1.8**	**2.3**	**1.3**	-2.0	2.0	5.0	5.4	**2.6**	*1.9*	5.0	3.4	**3.6**	*1.9*
Investment	**4.2**	**5.2**	**1.9**	**-1.8**	7.6	26.9	14.1	11.0	**14.9**	*10.1*	10.0	10.4	**7.1**	*5.4*
› Residential investment	**3.5**	**6.9**	**2.9**	**-4.0**	-2.3	15.0	14.5	12.3	**9.9**	-	10.0	8.0	**6.3**	-
› Non-residential investment	**4.4**	**-0.6**	**-1.7**	**-6.1**	4.0	28.0	15.0	13.3	**15.1**	-	13.0	12.0	**10.1**	-
Variation of inventories (contribution)	**0.0**	**0.1**	**0.0**	**-0.7**	0.4	1.5	0.1	-0.1	**0.5**	-	0.0	0.3	**0.0**	-
Exports	**3.5**	**3.0**	**-0.1**	**-12.9**	-5.0	18.0	9.0	7.5	**7.4**	*5.6*	8.0	9.0	**6.3**	*6.5*
Imports	**4.7**	**4.1**	**1.1**	**-9.3**	-1.0	27.0	11.0	10.0	**11.8**	*13.7*	8.5	8.7	**6.4**	*5.5*
Trade balance (contribution)	**-0.4**	**-0.4**	**-0.2**	**0.0**	-0.5	-0.6	0.8	0.4	**0.0**	-	-0.5	-0.6	**0.0**	-
Current account balance (% of GDP)	**-2.3**	**-2.4**	**-2.3**	**-3.1**	-	-	-	-	**-3.3**	*-3.6*	-	-	**-2.8**	*-3.2*
Budget deficit (% of GDP)	**-3.4**	**-4.2**	**-4.7**	**-15.6**	-	-	-	-	**-15.0**	*-10.5*	-	-	**-8.5**	*-7.0*
Public debt (% of GDP)	**76.0**	**77.4**	**79.2**	**138.0**	-	-	-	-	**140.5**	-	-	-	**143.0**	-
Unemployment (%)	**4.4**	**3.9**	**3.9**	**8.1**	6.2	5.8	5.0	4.7	**5.4**	*5.4*	4.5	4.2	**4.0**	*4.2*
Global inflation	**2.1**	**2.4**	**1.8**	**1.3**	1.9	3.9	2.8	2.8	**2.9**	*2.9*	2.5	2.3	**2.3**	*2.3*

* Consensus

Employment is bouncing back quickly...

› The COVID-19 crisis has substantially impacted the job market, with over 30 million people having claimed unemployment to varying degrees. The increase appears to be much more brutal in scale and its speed than during other recessions. At the peak of the 2008 crisis, some 12 million people filed for unemployment. However, the recovery is happening much more quickly than for other crises. We estimate that unemployment will return to its pre-crisis level of 4% by the end of 2022.

... but remains well below pre-crisis levels

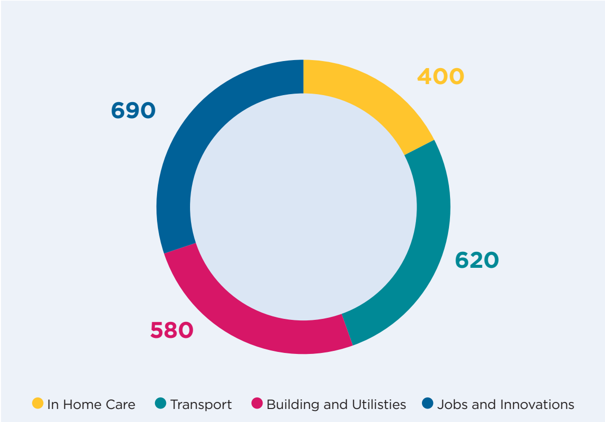


Sources: Refinitiv, Edmond de Rothschild Economic Research

Biden's spending plans are worth...

› After the adoption of the rescue plan in March 2021, two plans still have to be debated in Congress. The American Jobs Plan Act is the backbone of the modernization of American infrastructure. It is worth $2.3 trillion over ten years. The plan also aims to support "sensitive" industries such as semi-conductors and R&D, as well as injecting $400 billion into home care. Its goal is to stimulate short-term growth (we calculate that it will generate additional GDP growth of 0.5% in 2022) and to prepare for future growth by kick-starting the energy transition through an estimated $400 billion in investment.

... $6 trillion

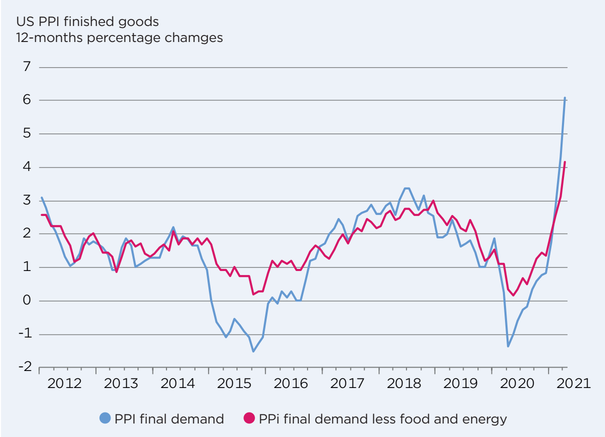


Sources: CBO, Edmond de Rothschild Economic Research

Supply chain difficulties...

› The epidemic has disrupted global supply chains. Public health protocols on both exports and imports have increased transportation times, often by several months, and reduced production (sick workers, factory closures). This has also negatively affected the production chain. For example, the fivefold increase in lead prices has on average increased the cost of building a house by $36,000. These rises are linked to the epidemic. As vaccination progresses and the epidemic recedes, production and freight forwarding should be easier. We therefore believe that this phenomenon will only be temporary and that, by the end of 2021, supply chains should have returned to normal, which should lead to more moderate inflation.

... should only be temporary



Sources: Refinitiv, Edmond de Rothschild Economic Research

Eurozone

Economic rebound underway, albeit later than expected

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- **In the eurozone, the pandemic has resulted in W-shaped rather than V-shaped GDP growth**
- **A significant rebound should be underway which would then be maintained by fiscal plans**
- **After spiking in recent months, inflation is expected to remain moderate, consolidating the ECB's position**

The eurozone has been the major economic region where relatively severe COVID-19 restrictions during the second wave of the pandemic last autumn and the third, which is currently drawing to an end, have had a particularly adverse effect on the economy. In addition to suffering a greater initial shock, the eurozone economy has therefore been stymied for longer than those of the United States or China. Vaccination campaigns also took longer to get going throughout the EU.

- These circumstances have resulted in greater and more persistent damage to the economy, delaying the eurozone's economic recovery in comparison with other major economic regions.
- With the progressive lifting of public health restrictions and the progress of vaccination campaigns, a substantial rebound in the economy is expected beginning in the second quarter of 2021.
- Vigorous growth is anticipated until the end of the year, at levels significantly above the pre-crisis average, at least throughout our forecast horizon. The eurozone's GDP should also return to pre-crisis levels in Q2 2022.
- There seem to be differences in economic trends from one eurozone country to another, with Germany and, to a lesser extent, France expected to recover more quickly than Italy and especially Spain.

The ECB's policy will likely remain accommodating until at least the end of 2022. This would complement the fiscal stimulus measures, soon to be extended through the Next Generation EU (NGEU) plan, which are expected to support a recovery both in economic activity and in the labour market, and then help sustain that momentum. The coming fiscal measures are likely to focus primarily on investment by businesses and by the state, but households will also play a key role.

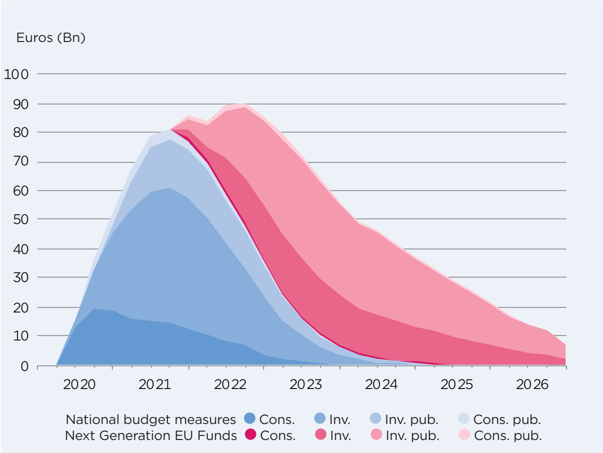
- Although they are gradually being withdrawn, the employment support schemes implemented seem to have allowed households to hold on to most of their purchasing power. Households have therefore been able to set aside considerable excess savings, which already amount to over 5.0% of eurozone GDP.
- The saving rate should taper over the next few quarters, which would gradually increase household spending, benefiting consumption, in particular, but also residential investment. This will be particularly true in the countries worst affected by the crisis, where the saving rate has risen the most, in relative terms.

EUROZONE					2021						2022			
% annual	**2017**	**2018**	**2019**	**2020**	Q1	Q2f	Q3f	Q4f	**2021f**	*C**	Q1f	Q2f	**2022f**	*C**
GDP	**2.7**	**1.9**	**1.3**	**-6.7**	-1.8	12.7	1.6	3.7	**4.0**	4.1	**5.5**	5.1	4.9	*4.2*
GDP (quarterly %)	-	-	-	-	-0.6	1.5	1.4	1.4	-	-	1.2	**1.1**	-	-
Private consumption	**1.9**	**1.5**	**1.3**	**-8.0**	-4.5	11.0	0.8	5.9	**3.3**	*2.9*	8.5	**7.9**	6.3	*4.9*
Public consumption	**1.1**	**1.2**	**1.8**	**1.2**	2.8	5.4	1.3	1.3	**2.7**	*3.2*	1.7	**1.7**	1.5	*1.4*
Investment	**4.2**	**3.2**	**5.7**	**-8.4**	-3.7	16.8	4.7	4.3	**5.5**	*5.3*	6.1	**5.3**	4.7	*4.8*
› Residential investment	**5.7**	**3.8**	**2.1**	**-13.2**	-4.9	17.5	5.5	5.1	**5.7**	-	6.7	**4.9**	4.7	-
› Non-residential investment	**3.8**	**3.8**	**3.4**	**-5.7**	-3.5	15.5	3.9	3.5	**4.9**	-	5.8	**5.5**	4.8	-
Variation of inventories (contribution)	**0.2**	**0.1**	**-0.5**	**-0.3**	-0.3	-0.4	1.0	0.4	**0.2**	-	0.0	**0.0**	0.1	-
Exports	**5.9**	**3.6**	**2.5**	**-9.6**	-1.4	22.9	6.2	5.3	**8.3**	*8.4*	5.0	**4.8**	4.9	*5.9*
Imports	**5.4**	**3.6**	**3.9**	**-9.2**	-4.1	18.3	9.5	8.5	**8.1**	*7.0*	7.6	**6.9**	5.2	*5.4*
Trade balance (contribution)	**0.4**	**0.1**	**-0.5**	**-0.5**	1.3	2.4	-1.2	-1.2	**0.3**	-	-1.0	**-0.8**	0.0	-
Unemployment (%)	**9.1**	**8.2**	**7.6**	**8.0**	8.2	8.3	9.2	9.1	**8.7**	*8.4*	8.9	**8.6**	8.5	*8.3*
Global inflation	**1.5**	**1.8**	**1.2**	**0.3**	1.1	2.0	2.4	2.6	**2.0**	*1.7*	1.9	**1.6**	1.6	*1.3*
Current account balance (% of GDP)	**3.1**	**3.1**	**2.7**	**3.0**	-	-	-	-	**3.2**	*2.5*	-	-	3.0	*2.4*
Budget deficit (% of GDP)	**-1.0**	**-0.5**	**-0.6**	**-7.2**	-	-	-	-	**-8.4**	*-7.0*	-	-	-3.1	*-4.3*
Public debt (% of GDP)	**87.8**	**87.9**	**84.2**	**100.0**	-	-	-	-	**102.8**	-	-	-	100.6	-

* Consensus

Next Generation EU is expected to progressively take over where national stimulus plans left off

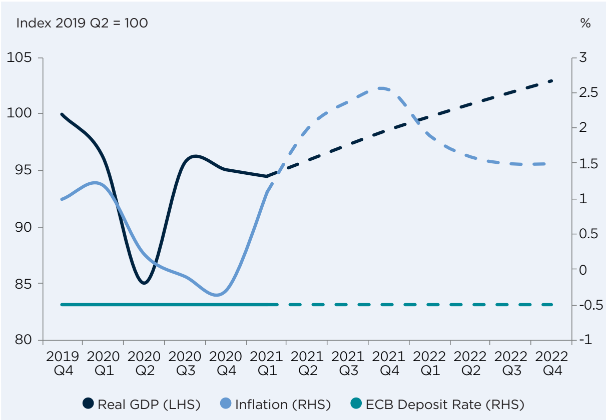
› National fiscal stimulus measures have supported economic activity since the start of the crisis, first targeting consumer spending, then private and public investment, and, to a lesser degree, public spending. From late summer 2021, NGEU should start to pick up where national plans left off, especially through capital expenditure, which would continue to stimulate GDP growth. The combined fiscal effect of the national stimulus plans and NGEU funding should peak in Q3 2022. When NGEU funding ceases at the end of 2026, all these plans should have enabled eurozone GDP to return almost to the level it would have reached if the crisis had not happened.



Sources: IMF, National Gov., Commission européenne, Edmond de Rothschild Economic Research

Inflation is expected to accelerate alongside economic activity, though it will remain moderate after spiking in 2021

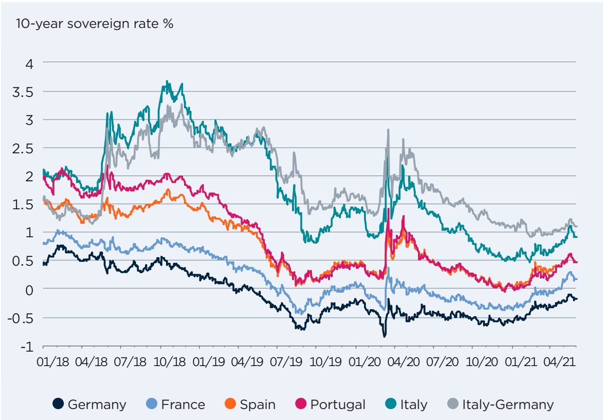
› The COVID-19 crisis tipped the eurozone into deflation in Q3 2020. With the significant rebound in activity in progress, along with a rise in demand for commodities, eurozone inflation has begun to accelerate. The rate of acceleration will grow from Q2 2021, in part due to international supply chain tensions that are driving up production costs, leading to sharp spikes in inflation. However, this is likely to be a short-lived phenomenon. Inflation should become more moderate in 2022, remaining below the ECB's target and not in itself representing an obstacle to the central bank's accommodating policy.



Sources: Eurostat, ECB, Edmond de Rothschild Economic Research

The rise in sovereign rates, which is expected to continue, will remain within reasonable limits, as will interest rate spreads

› The ECB has stepped up its asset purchases since the start of the year to provide optimal financial conditions and control rises in sovereign rates, which are expected to continue. As the ECB continues to pursue these objectives and curb sovereign rate spreads between countries, its main tool will remain the Pandemic Emergency Purchase Programme (PEPP) until it ends on 31 March 2022. The €1.85 trillion earmarked for the PEPP should be used in its entirety, but if circumstances so required, the programme could be extended or other existing programmes could cover an increase in sovereign debt purchases. In addition, the key rates should not change between now and then, and the euro should remain fairly stable.



Sources: BCE, Edmond de Rothschild Economic Research

Germany

Industry still working in its favour

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› **After some setbacks in 2021, industry looks set to continue to drive German growth**

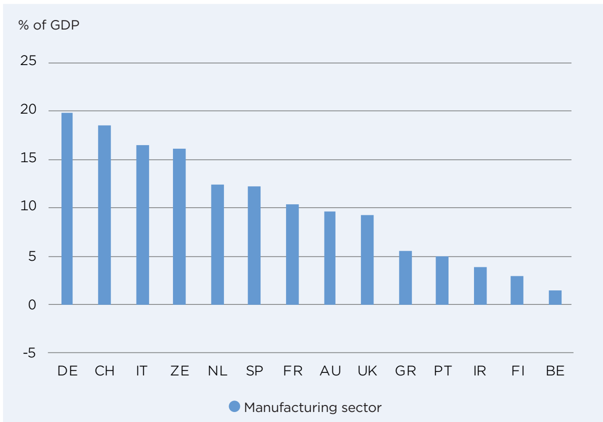
› **The federal elections should not have any economic impact, at least in the short term**

The end of the temporary VAT cut and the tightening of public health restrictions weighed heavily on the economy in the first quarter of 2021, especially through consumption, whereas Germany had been growing more vigorously than other major eurozone countries in Q4 2020. With the lifting of restrictions, economic activity should bounce back sharply over the next few months. Subsequently, Germany's fiscal stimulus plans are expected to further boost the economy, particularly through investment and, to a lesser extent, consumer spending. They are the largest-scale plans in the eurozone and, together with a marginal contribution from the NGEU fund, total over €500 billion, which equates to nearly 15% of German GDP. Construction activity, which, unlike in other countries, continued to grow in Germany in 2020, is expected to remain high thanks to a robust residential sector and substantial infrastructure spending due to take place gradually.

The results of the German federal elections on 26 September 2021 should not have a noticeable impact, at least within our forecast horizon. If the current political direction were to be largely maintained, with a coalition led by the CDU/CSU, it would seem that there is no risk of too precipitous a return to a balanced budget. Conversely, a more left-leaning coalition not including the CDU/CSU would find it difficult to further increase effective public spending over and above the considerable amounts already planned up to the end of 2022.

As services accelerate, manufacturing activities will again drive growth, particularly in Germany

› Service activities are expected to make a greater contribution to growth with the lifting of restrictions beginning in Q2 2021, but manufacturing and construction will still provide significant support. Given that manufacturing activity in Q1 was 3.1% lower than pre-crisis levels, activity prospects are at a historic high. This is the case despite the increase in production costs and the supply chain tensions which will likely continue to limit the potential for activity over the next few months, particular in the automotive industry. In addition, Germany is expected to take full advantage of its manufacturing sector, as well as its export exposure to the United States and China in particular.



Sources: Eurostat National Stat. offices, Edmond de Rothschild Economic Research

GERMANY % annual	2017	2018	2019	2020	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	2021f	C*	2022 Q1f	2022 Q2f	2022f	C*
GDP	2.8	1.3	0.6	-5.1	-3.0	9.6	2.2	3.0	3.0	3.3	6.0	5.1	5.1	4.1
GDP (quarterly %)	-	-	-	-	-1.7	2.0	1.3	1.3	-	-	1.2	1.2	-	-
Private consumption	1.8	1.5	1.6	-6.3	-5.6	6.2	2.2	3.4	1.5	1.5	10.5	9.3	7.9	5.1
Public consumption	1.6	1.2	2.7	3.3	1.7	0.4	0.2	0.8	0.8	1.9	1.4	1.2	1.2	1.3
Investment	3.2	3.6	2.6	-3.9	-1.0	6.3	4.4	4.3	3.5	2.8	6.5	4.5	5.1	3.7
› Residential investment	5.1	4.5	0.7	-13.2	-2.0	14.9	3.9	5.1	5.5	-	7.9	5.8	6.0	-
› Non-residential investment	1.6	2.7	3.8	1.0	-1.5	2.8	4.6	3.6	2.4	-	3.9	2.8	3.1	-
Variation of inventories (contribution)	0.7	-0.1	-0.7	-0.7	-0.3	-0.1	1.7	0.4	0.4	-	0.3	0.1	0.1	-
Exports	5.4	2.5	1.0	-10.2	-1.0	25.9	7.1	5.5	9.4	10.2	4.6	8.9	8.1	5.8
Imports	5.8	3.8	2.6	-9.0	-1.8	14.4	9.6	8.6	7.7	7.1	12.1	15.0	12.1	4.5
Trade balance (contribution)	0.2	-0.4	-0.6	-1.1	0.3	5.2	-0.6	-1.0	1.0	-	-3.0	-2.0	-1.3	-
Unemployment (%)	5.7	5.2	5.0	5.9	6.0	6.0	5.9	5.7	5.9	5.9	5.5	5.4	5.3	5.5
Global inflation	1.7	1.9	1.4	0.4	1.7	2.4	2.9	3.3	2.6	2.4	1.8	1.5	1.7	1.4
Current account balance (% of GDP)	8.0	7.3	7.8	7.2	-	-	-	-	8.1	6.8	-	-	6.6	6.7
Budget deficit (% of GDP)	1.2	1.9	1.4	-4.2	-	-	-	-	-7.5	-5.0	-	-	-2.3	-2.2
Public debt (% of GDP)	65.3	61.9	61.1	69.8	-	-	-	-	73.6	-	-	-	71.7	-

* Consensus

France

A fast recovery in 2021

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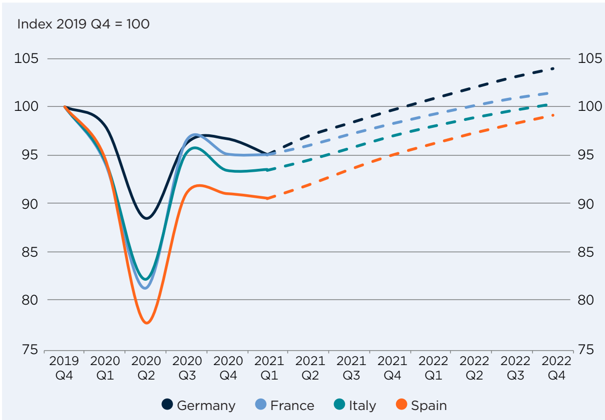
- **The French economy sprung a surprise with positive growth in Q1 2021**
- **Social protests could be reignited with unemployment at over 9%**

After another contraction in Q4 2020, GDP remained almost unchanged in Q1 2021. This reflects the successful adaptation by economic players and the greater effectiveness of the often more targeted health measures adopted from the second wave of the pandemic onwards. Investment made a particularly significant contribution to this recent recovery, as well as a noticeable increase in inventory, while the trade balance remained negative. Starting late in the summer, €40 billion in funding from Next Generation EU will reinforce France's fiscal stimulus measures, which will then account for 10.5% of GDP.

Social protests could take centre stage over the coming quarters. The unemployment rate is forecast to reach 9.3% before the presidential election in May 2022. No previous French president has been re-elected with such figures: Sarkozy and Hollande lost in 2012 and 2017 with unemployment at 9.7% and 9.5% respectively, while Mitterrand and Chirac were voted back in office in 1988 and 2002 with unemployment at 8.8% and 8.2% respectively. While it is thought that the economic impact of a "yellow vest"-style movement would be moderate (0.1% of GDP per quarter), there would be greater uncertainty for investors. This would increase upward pressure on French sovereign rates and could lead the ECB to take further action. The upcoming election is also likely to deter the government from pursuing reforms perceived as unpopular, which could have a negative impact on medium- and long-term growth.

The return to pre-crisis GDP levels is expected to happen earlier in France than in the southern countries, but after Germany

- Though France is expected to be the first large eurozone country to overcome the economic consequences of the 2nd and 3rd waves of the pandemic, its growth rate in Q2 should be relatively low, particularly compared to Germany, whose GDP should return to pre-crisis levels sometime between Q4 2021 and Q1 2022, one or two quarters before France. Though France's fiscal stimulus package is weaker than Germany's, it should still add 0.2% to the country's potential growth rate over the coming years, meaning that by 2026, France's activity levels will be close to those it could have reached if the crisis had not taken place.



Sources: Refinitiv Datastream, Edmond de Rothschild Economic Research

FRANCE % annual	2017	2018	2019	2020	2021 Q1	Q2f	Q3f	Q4f	2021f	C*	2022 Q1f	Q2f	2022f	C*
GDP	2.4	1.8	1.8	-8.0	1.2	17.9	0.7	3.2	5.8	5.6	4.1	4.3	4.0	4.0
GDP (quarterly %)	-	-	-	-	-0.1	1.0	1.2	1.1	-	-	1.0	0.9	-	-
Private consumption	1.7	0.9	1.9	-7.2	-1.2	13.5	1.0	6.9	5.1	3.4	7.7	7.4	5.7	4.5
Public consumption	1.4	0.8	1.0	-3.2	3.6	15.7	1.6	1.6	5.6	5.3	1.7	1.9	1.9	1.8
Investment	5.0	3.3	4.1	-9.0	8.2	27.9	5.7	5.3	11.8	10.0	4.2	6.2	4.9	4.1
› Residential investment	4.5	2.4	4.0	-14.2	8.4	31.5	0.5	3.9	11.1	-	3.2	6.5	4.4	-
› Non-residential investment	4.6	2.4	4.4	-13.2	11.5	39.5	6.8	6.2	16.0	-	4.9	4.1	4.8	-
Variation of inventories (contribution)	0.2	0.0	-0.4	0.2	-0.3	-0.6	0.0	-0.5	-0.3	-	-0.3	-0.9	-0.1	-
Exports	4.6	4.6	1.5	-16.1	-4.3	28.9	7.4	4.1	9.0	9.6	6.0	5.7	5.4	5.3
Imports	4.7	3.1	2.4	-12.1	-1.9	21.8	11.9	9.8	10.4	7.8	10.5	8.3	7.6	4.9
Trade balance (contribution)	-0.1	0.4	-0.3	-1.3	-0.5	0.8	-1.7	-2.0	-0.9	-	-1.6	-1.1	-1.0	-
Unemployment (%)	9.4	9.0	8.5	8.1	7.9	9.1	9.3	9.5	9.0	8.5	9.4	9.3	9.2	8.5
Global inflation	1.2	2.1	1.3	0.5	1.0	1.8	2.1	1.9	1.7	1.4	1.5	1.5	1.4	1.2
Current account balance (% of GDP)	-0.7	-0.6	-0.8	-2.0	-	-	-	-	-1.6	-0.7	-	-	-1.3	-0.6
Budget deficit (% of GDP)	-2.9	-2.3	-3.0	-9.2	-	-	-	-	-8.4	-10.7	-	-	-4.8	-4.9
Public debt (% of GDP)	99.8	99.0	100.0	115.7	-	-	-	-	117.2	-	-	-	116.6	-

* Consensus

Italy • Spain • Portugal

Big beneficiaries of EU funds

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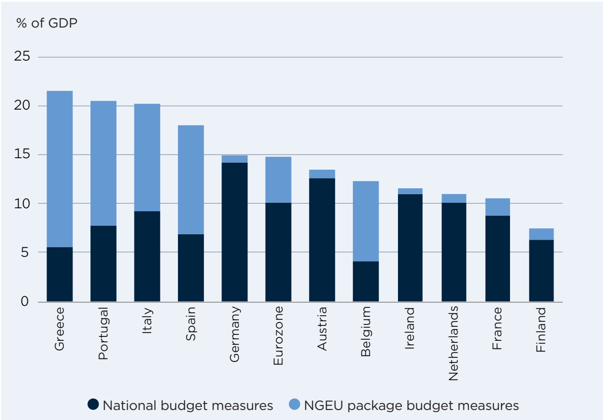
› **Draghi's government makes the Italian spending plan for EU funds more credible**

› **With unemployment likely to rise further, jobs remain the major problem in Spain**

› **The scale of the economic recovery in Portugal will be heavily dependent on the tourist season**

While the Italian economy contracted again in Q4 2020, like in France, it managed to stabilise in Q1 2021. The lifting of COVID-19 restrictions, which began earlier in Italy than in other major eurozone countries, should enable the country to bounce back strongly from Q2 onwards. While the appointment of Mr Draghi as Prime Minister in February reassured the markets by avoiding a political crisis, the national fiscal stimulus was increased by €32 billion in Q1, pending the late-summer arrival of European funding (NGEU), of which Italy will be the main beneficiary. Draghi's government should be able to propose reforms that are of long-term benefit to the economy, and to map out a credible plan for using the EU funds. In light of ECB policy and low interest rates, as well as the prospects of an economic recovery, Italian debt should remain on a sustainable path, though it is expected to peak at 160% of GDP in 2021. The two main risks for Italy over the coming quarters will be a significantly delayed or botched deployment of NGEU funds and a fresh political crisis that could arise from the Northern League's desire to trigger another general election before May 2023.

The southern eurozone countries will receive most of the NGEU funds, and they will need them



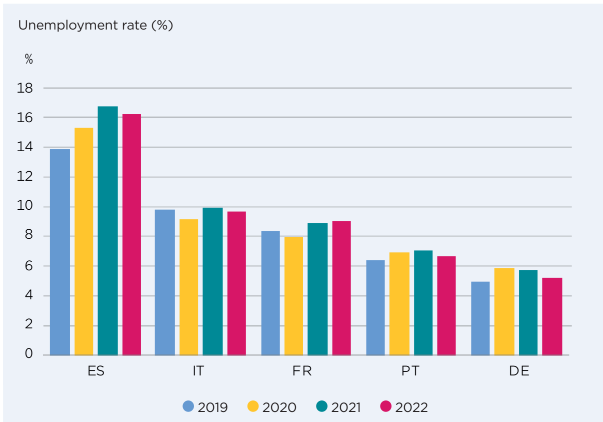
Sources: IMF, European Commission, Edmond de Rothschild Economic Research

ITALY % annual	2017	2018	2019	2020	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	2021f	2022 Q1f	2022 Q2f	2022f
GDP	1.7	0.8	0.3	-8.9	-0.9	14.8	0.6	3.7	4.5	5.1	4.5	4.2
GDP (quarterly %)	-	-	-	-	0.1	1.1	1.3	1.3	-	1.0	0.9	-
Private consumption	1.5	1.0	0.3	-10.7	-3.8	10.0	0.1	5.1	2.8	7.5	7.1	5.9
Public consumption	-0.1	0.1	-0.8	1.6	1.6	3.0	2.8	1.2	2.2	1.2	0.4	0.7
Investment	3.4	2.9	1.1	-9.2	7.3	29.7	3.2	3.8	11.0	4.3	4.1	3.8
› Residential investment	6.4	4.5	0.3	-15.2	8.3	36.5	5.8	3.2	13.5	3.8	3.9	3.7
› Non-residential investment	1.8	1.6	2.2	-6.6	7.6	34.2	-1.9	2.1	10.5	5.1	6.7	4.8
Variation of inventories (contribution)	0.2	0.0	-0.7	-0.3	-0.6	-0.3	0.9	0.6	0.2	-0.3	0.0	-0.1
Exports	6.0	1.6	1.9	-14.5	0.3	32.5	5.3	6.5	11.1	8.3	9.6	7.6
Imports	6.5	2.8	-0.5	-13.1	-0.3	23.0	12.6	11.4	11.7	12.0	11.5	8.9
Trade balance (contribution)	0.0	-0.3	0.7	-0.8	0.2	2.5	-1.7	-1.2	-0.1	-0.9	-0.3	-0.2
Unemployment (%)	11.3	10.7	10.0	9.3	10.2	10.1	10.0	9.9	10.1	9.9	9.8	9.8
Global inflation	1.3	1.2	0.6	-0.1	0.8	1.4	1.6	1.7	1.4	1.1	1.0	1.1
Current account balance (% of GDP)	2.6	2.5	2.7	3.5	-	-	-	-	2.8	-	-	3.2
Budget deficit (% of GDP)	-2.4	-2.2	-1.6	-9.5	-	-	-	-	-11.6	-	-	-5.9
Public debt (% of GDP)	134.0	135.0	137.0	155.8	-	-	-	-	159.7	-	-	156.5

* Consensus

Having suffered the worst economic contraction in Europe in 2020, Spain managed to avoid further decline in Q4 2020 and to limit the correction in Q1 2021. Spain should enjoy a slightly quicker recovery than the eurozone average for the rest of 2021. However, Spain could suffer from the fact that, in proportion to the economic losses suffered, its national fiscal stimulus measures are weaker than those taken by other eurozone countries. Thus, despite a slightly greater NGEU contribution than Italy as a proportion of GDP, the Spanish economy isn't expected to return to its pre-crisis levels before 2023. In particular, consumer spending and property investment are expected to be more restrained over the next few quarters due to an unemployment rate that is already the highest in the eurozone and looks set to rise. The recent electoral setbacks suffered by the left-wing governing coalition and its reluctance to carry out reforms are risks.

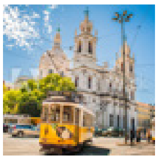
The unemployment rate will often not return to pre-crisis levels before the end of 2022



Sources: National Stat. Offices, Edmond de Rothschild Economic Research

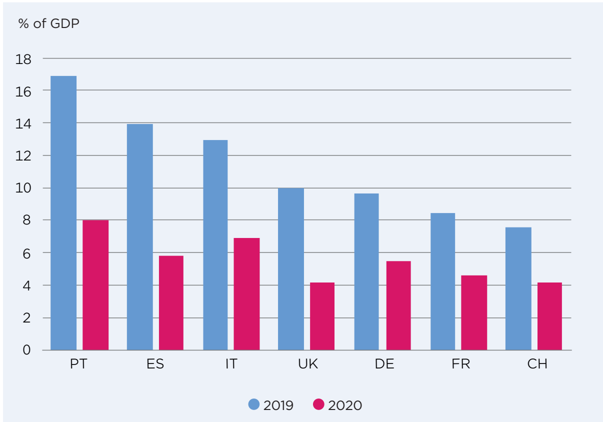
SPAIN **% annual**					2021					2022		
	2017	**2018**	**2019**	**2020**	Q1	Q2f	Q3f	Q4f	**2021f**	Q1f	Q2f	**2022f**
GDP	**2.9**	**2.4**	**2.0**	**-10.8**	-4.2	18.3	2.8	4.4	**5.3**	6.2	**5.8**	5.4
GDP (quarterly %)	**-**	**-**	**-**	**-**	-0.5	1.5	1.7	1.6	**-**	1.2	**1.2**	-
Private consumption	**3.0**	**1.8**	**0.9**	**-12.1**	-4.0	20.5	1.8	3.6	**5.5**	6.5	**6.4**	6.3
Public consumption	**1.0**	**2.6**	**2.3**	**3.8**	4.1	4.5	3.8	2.7	**3.8**	2.0	**1.1**	1.1
Investment	**6.8**	**6.1**	**2.7**	**-11.4**	-3.2	23.0	4.5	6.1	**7.6**	8.8	**9.1**	7.2
› Residential investment	**9.2**	**5.4**	**4.4**	**-13.0**	2.0	46.3	5.2	6.9	**15.1**	11.8	**9.9**	8.3
› Non-residential investment	**6.7**	**9.3**	**1.6**	**-14.0**	-7.8	16.8	2.8	4.9	**4.2**	6.8	**7.6**	6.0
Variation of inventories (contribution)	**0.0**	**0.3**	**-0.1**	**-0.3**	-0.2	0.7	-0.1	-0.1	**0.1**	0.2	**0.1**	0.3
Exports	**5.5**	**2.3**	**2.3**	**-20.2**	-10.0	37.1	10.5	8.9	**11.6**	10.9	**10.5**	8.3
Imports	**6.8**	**4.2**	**0.7**	**-15.8**	-5.2	33.3	10.0	6.4	**11.1**	9.1	**9.1**	7.3
Trade balance (contribution)	**-0.2**	**-0.5**	**0.6**	**-2.1**	-0.7	4.4	0.4	1.6	**1.4**	1.1	**0.8**	0.6
Unemployment (%)	**17.2**	**15.3**	**14.1**	**15.6**	15.5	16.5	18.2	18.1	**17.1**	18.1	**16.6**	16.5
Global inflation	**2.0**	**1.7**	**0.8**	**-0.3**	0.5	2.4	2.5	2.4	**2.0**	1.6	**1.3**	1.2
Current account balance (% of GDP)	**2.7**	**1.9**	**2.0**	**0.7**	-	-	-	-	**-0.4**	-	**-**	1.1
Budget deficit (% of GDP)	**-3.0**	**-2.5**	**-2.8**	**-11.0**	-	-	-	-	**-7.9**	-	**-**	-5.9
Public debt (% of GDP)	**98.6**	**98.9**	**97.8**	**120.0**	-	-	-	-	**120.1**	-	**-**	118.2

*** Consensus**



While economic activity in Portugal had declined less in 2020 than in other southern eurozone countries and France, and it increased in Q4 2020, the strict lockdown measures imposed in response to the fresh wave of COVID-19 infections in Q1 led to a particularly harsh correction of GDP. However, Portugal is one of the eurozone countries that lifted restrictions the fastest and most noticeably starting at the end of Q1. The rebound of activity in Q2 should therefore be considerable. In Q3, tourist activities, which account for a higher proportion of GDP than in other countries, are still unlikely to be able to operate at full capacity. Thereafter, fiscal measures to compensate for the relatively large loss of GDP should help Portuguese GDP return to pre-crisis levels faster than Spain's.

proportion of economic activity linked to tourism by country



Sources: Eurostat, Edmond de Rothschild Economic Research

PORTUGAL % annual	**2017**	**2018**	**2019**	**2020**	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	**2021f**	2022 Q1f	2022 Q2f	**2022f**
GDP	**3.5**	**2.8**	**2.5**	**-7.6**	-5.4	14.2	3.2	4.2	**4.1**	9.0	**6.0**	5.8
GDP (quarterly %)	**-**	**-**	**-**	**-**	-3.3	3.8	2.5	1.2	**-**	1.1	**1.0**	
Private consumption	**2.1**	**2.7**	**2.7**	**-6.0**	-7.7	12.5	0.9	4.0	**2.4**	10.8	**8.1**	8.2
Public consumption	**0.2**	**0.6**	**0.7**	**0.4**	5.6	10.9	4.3	4.2	**6.3**	3.9	**3.8**	3.7
Investment	**11.5**	**6.2**	**5.4**	**-2.0**	-1.0	11.6	4.1	5.3	**5.0**	7.4	**6.0**	5.3
› Residential investment	**32.9**	**-49.5**	**85.3**	**-55.4**	-1.5	2.4	2.8	2.6	**1.6**	3.6	**4.6**	5.1
› Non-residential investment	**17.6**	**2.1**	**9.3**	**-34.7**	0.9	1.5	1.1	0.5	**1.0**	1.5	**2.5**	3.0
Variation of inventories (contribution)	**0.1**	**0.3**	**0.1**	**-0.6**	-0.4	-0.2	0.6	0.2	**0.1**	0.0	**-0.1**	-0.3
Exports	**8.4**	**4.2**	**4.0**	**-18.7**	-7.5	49.0	10.9	7.2	**14.9**	9.2	**7.9**	7.7
Imports	**8.1**	**5.0**	**4.7**	**-12.1**	-5.0	36.2	8.6	7.1	**11.7**	9.8	**10.8**	10.5
Trade balance (contribution)	**0.2**	**-0.3**	**-0.3**	**-2.9**	-1.0	2.4	0.7	-0.1	**0.5**	-0.5	**-1.4**	-1.3
Unemployment (%)	**9.0**	**7.0**	**6.6**	**7.1**	6.7	7.0	7.4	7.5	**7.2**	7.2	**6.9**	6.8
Global inflation	**1.6**	**1.2**	**0.3**	**-0.1**	0.2	0.4	0.6	0.5	**0.4**	0.4	**0.6**	0.9
Current account balance (% of GDP)	**1.3**	**-0.6**	**0.0**	**-1.1**	-	-	-	-	**-0.7**	-	**-**	-0.6
Budget deficit (% of GDP)	**-3.0**	**-0.4**	**0.2**	**-5.7**	-	-	-	-	**-4.6**	-	**-**	-3.6
Public debt (% of GDP)	**126.0**	**121.9**	**120.0**	**133.6**	-	-	-	-	**127.0**	-	**-**	122.5

*** Consensus**

FOCUS

World trade
Dynamic

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- **The pandemic has mostly affected European trade**
- **US-China trade has picked up again**
- **World trade will benefit from the return of investment**

Most of the impact of the pandemic on world trade took place between February and May 2020, when it shrank by 14.3%. Goods exports reached their lowest point in April before stagnating, while imports bottomed out in May. European trade was hit the hardest. The 23.1% drop in eurozone exports accounts for almost half of the global decline over the period. Meanwhile, European goods imports fell 18% by volume.

They subsequently bounced back strongly when lockdown restrictions were eased. World trade grew by an average of 2.3% per month between June 2020 and March 2021. While the United States and the European Union only returned to their pre-crisis goods export volumes in early 2021, Asia had already exceeded its pre-crisis figures by mid-2020. On the imports front, China and the United States returned to their December 2019 goods import volumes in April and August respectively, while the EU only did so in March 2021.

Growth of global trade flows accelerated in early 2021, with 4.3% quarter-on-quarter growth in Q1—twice the rate recorded in Q4 2020 (2.2%). Asia has been the main driving force in world trade year-to-date in 2021. It was responsible for more than three quarters of world trade growth by volume in the first quarter. The US-China trade war has had only a limited impact.

After falling 9.5% per year in 2018 and 2019, US exports to China rose 17% in 2020, including a 40% doubling in agricultural product exports. However, Chinese exports to the US by value remained below their 2018 levels in 2020.

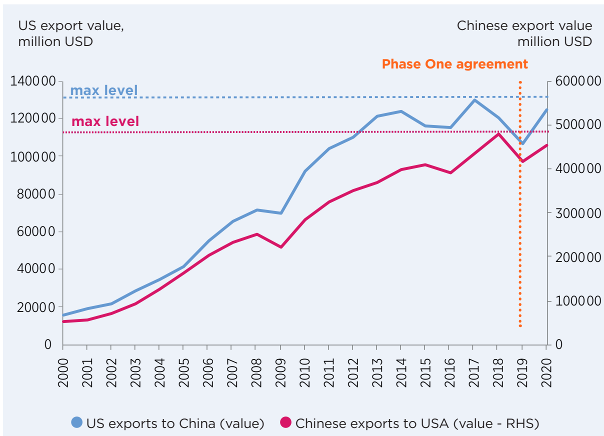
In addition, the US has replaced some of its Chinese imports with substitutes from other countries, particularly Taiwan and Vietnam (electrical equipment and machinery) and Mexico (cars and electronics). In 2020, Asian developing countries' market share in US imports rose by 1.3 percentage points to 11.2%, while China's share climbed only 0.5% despite the Phase One Agreement of January 2020.

While trade flows between China and the United States will most likely continue to be affected by customs tariffs, the re-opening of Europe will boost international trade, which has been hit hard by the continent's difficulties. Granted, the lifting of health restrictions will increase consumption of services to the detriment of trade in goods, but renewed investment will fuel demand for intermediate and capital goods

World trade has recovered quickly

Sources: Edmond de Rothschild Economic Research

US-China trade remains weakened



Sources: Edmond de Rothschild Economic Research

Savings

A boost for consumption and property

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- **Substantial forced savings has been combined with precautionary savings**
- **Excess savings should shrink, gradually supporting greater economic activity**

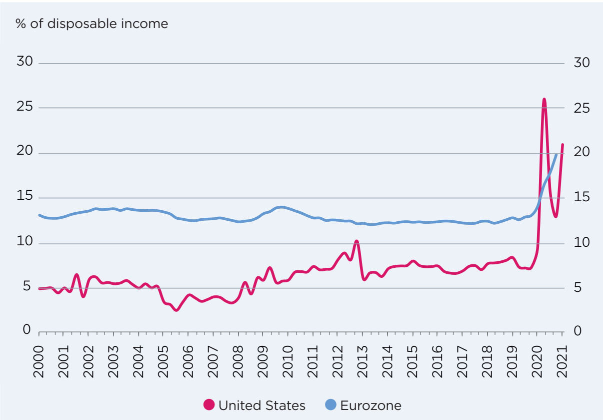
Since the beginning of the public health crisis, households have started to accumulate savings, particularly in the United States, where the saving rate rose from around 7.5% of disposable income to as much as 33.7%, and in the eurozone, where the rate increased from 12.9% to 19.9% between the pre-crisis period and Q1 2021. Within the eurozone, the countries worst hit by the pandemic are often those whose saving rate has increased the most, such as Spain, where the savings ratio more than doubled to 15%. The increase in the saving rate is relatively pronounced compared to what happened during the financial crisis of 2008, when it rose from 3.5% to 7.8% in the United States and from 12.5% to 14% in the eurozone. Forced saving has combined with precautionary savings, as households have not had access to certain goods and services due to the public health restrictions. In the eurozone, the econometric analysis shows that nearly 60% of the savings accumulated were forced.

The saving rate is now expected to gradually dwindle, since forced savings should fall drastically as the public health restrictions are lifted. However, it will not return to its pre-crisis levels – 12.9% of disposable income in the eurozone and 7.5% in the United States – before the end of 2022. Historically, we have seen that post-epidemic saving behaviour is linked to households' confidence in the future and the distribution of this "excess savings" among households by wealth (the most affluent households are those that save the most and wait the longest before consuming).

As the saving rate determines the flow that increases total savings, we can estimate the volume of excess savings accumulated since the start of the crisis. It is currently thought to be 10.3% of GDP in the United States and 5.4% in the eurozone. Since the saving rate is expected to fall, but remain higher than normal for a little while yet, excess savings should continue to rise until 2022, but at a tapering rate, which would mean spending would gradually increase, boosting economic activity.

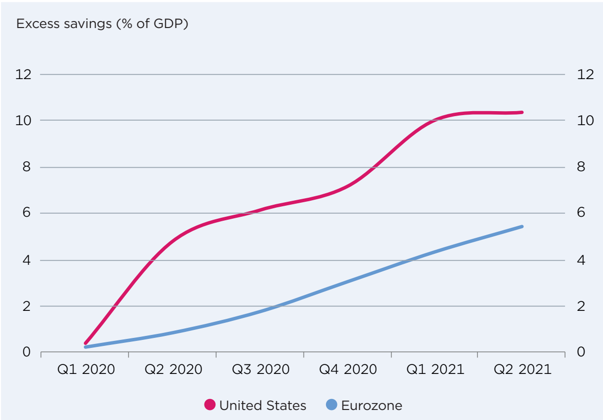
This additional spending would mostly be on consumption and property purchases, as households would be able to afford a higher down-payment, and their improved solvency would make it easier for them to get a mortgage. Another way in which "excess savings" could be used is to pay off mortgages and consumer loans for those who have returned to full-time employment after working on a short-time basis. If such saving continues until 2022, it could be a factor in supporting real asset prices.

Saving rates have increased considerably and will return to normal only gradually



Sources: BEA, ECB, Edmond de Rothschild Economic Research

Excess saving will continue to rise, but at a decreasing rate



Sources: BEA, ECB, Edmond de Rothschild Economic Research

Commodities

Cyclical upswing, amongst other things

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- **Commodity prices continue to rise in 2021**
- **In the longer term, industrial metals should benefit from the energy transition**
- **Volatile oil prices, fluctuating between $60 and $70 a barrel, with a target of $69 for the end of 2021 and $73 for the end of 2022**

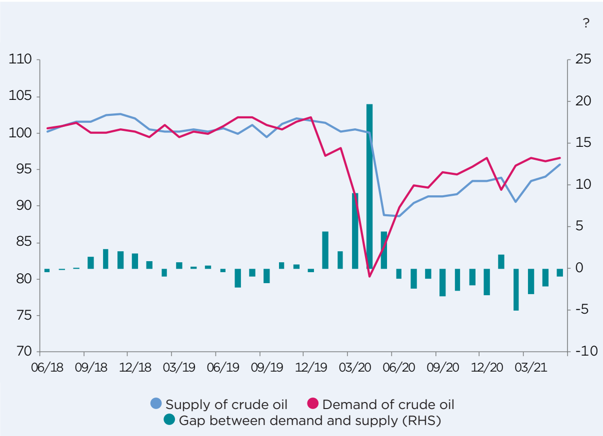
2020 was a year marked by highly volatile commodity prices, with Brent falling by around 60% to less than $20 a barrel in the spring, before rising again to hover between $60 and $70 over recent months. For many commodities, the rise we are seeing at present is largely based on cyclical factors, while for some, there are more structural factors at play. The COVID-19 restrictions have impacted demand for commodities, with oil demand falling by around 25% at one point in 2020. The progressive resumption of economic activity has kept prices up. China, which has suffered less than other countries and has captured 50% of world demand for commodities, has, like other countries, increased its inventory. In 2020, it doubled its corn purchases compared to 2019. Demand is boosted by massive stockpiling due to uncertainties surrounding the epidemic and the reopening of countries' economies. On the supply side, a great deal of activity has been halted as a result of falling demand and pandemic-related restrictions on exports and production. The mismatch between supply and demand partly explains the recent rise in prices. Lead prices have increased fivefold. In addition to these involuntary restrictions, there have been some deliberate ones. Russia has taxed wheat exports, limiting the rise in domestic bread prices and causing wheat prices to rise on the global market. OPEC+, which comprises the OPEC countries plus ten other states, including Russia, and accounts for around 40% of global oil production, decided in mid-2020 to reduce its supply by 7 million barrels per day in order to keep prices high.

In addition to cyclical factors, some commodities, particularly industrial metals, could derive lasting benefit from the emphasis placed on renewable energies and the energy transition. The constituent elements of this transition require large quantities of metals. Lithium, for instance, is present in 90% of batteries.

This rise in prices is impacting emerging economies, some of which are reliant on commodity exports (oil-producing countries, etc.), while others import them, like Egypt—one of the largest wheat importers. For the former, 2020 was a bad year (Saudi Arabia saw its public deficit reach 10% of GDP), while importing countries fared better, with growth of -0.7%, versus -4.2% for exporting countries. That situation should reverse in 2021, with exporters benefiting from the rise in prices and the importers suffering.

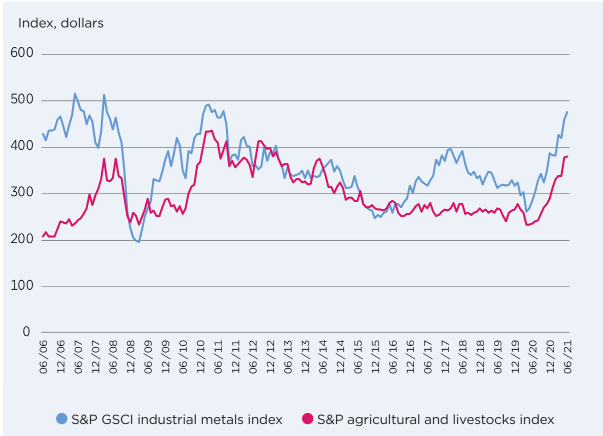
In the second half of the year, oil prices should hover in the region of $60 to $70 a barrel, with considerable volatility and a target of $69 for the end of 2021 and $73 for the end of 2022. The S&P GSCI agricultural commodities index could rise further due to restrictions on supply, ending 2021 at around 415 points before dwindling throughout 2022 to finish the year at around 375. Meanwhile, the price of precious metals could continue to rise, reaching around 500 points by the end of the year, before climbing more steadily in 2022 thanks to the energy transition.

Demand outstrips supply, driving price up...



Sources: Edmond de Rothschild Economic Research

... and for other commodities such as industrial metals and agricultural products, too



Sources: Edmond de Rothschild Economic Research

BRENT CRUDE OIL **% annual**	**2020**	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	**2021f**	2022 Q1f	2022 Q2f	**2022f**
Average	**43.0**	60.9	65.0	67.0	69.0	**65.5**	70.0	**71.5**	71.5
End of the period		55.0	67.0	69.0	69.5		71.0	**72.0**	73.0

S&P INDUSTRIAL METALS INDEX **% annual**	**2020**	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	**2021f**	2022 Q1f	2022 Q2f	**2022f**
Average	**43.0**	396.0	457.0	478.0	490.0	**455.0**	503.0	**519.0**	520.0
End of the period		424.0	465.0	485.0	500.0		515.0	**530.0**	540.0

S&P AGRICULTURAL & LIVESTOCKS INDEX **% annual**	**2020**	2021 Q1	2021 Q2f	2021 Q3f	2021 Q4f	**2021f**	2022 Q1f	2022 Q2f	**2022f**
Average	**43.0**	326.0	364.0	385.0	407.0	**370.0**	405.0	**390.0**	390.0
End of the period		336.0	380.0	398.0	415.0		395.0	**380.0**	375.0

Forecasts : Edmond de Rothschild Economic Research

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