



A shot in the arm (for some)

Macroeconomic & Rates Outlook – March 2021 Update

Based on information available up to 30 March 2021



The perfect inflation storm of 2021

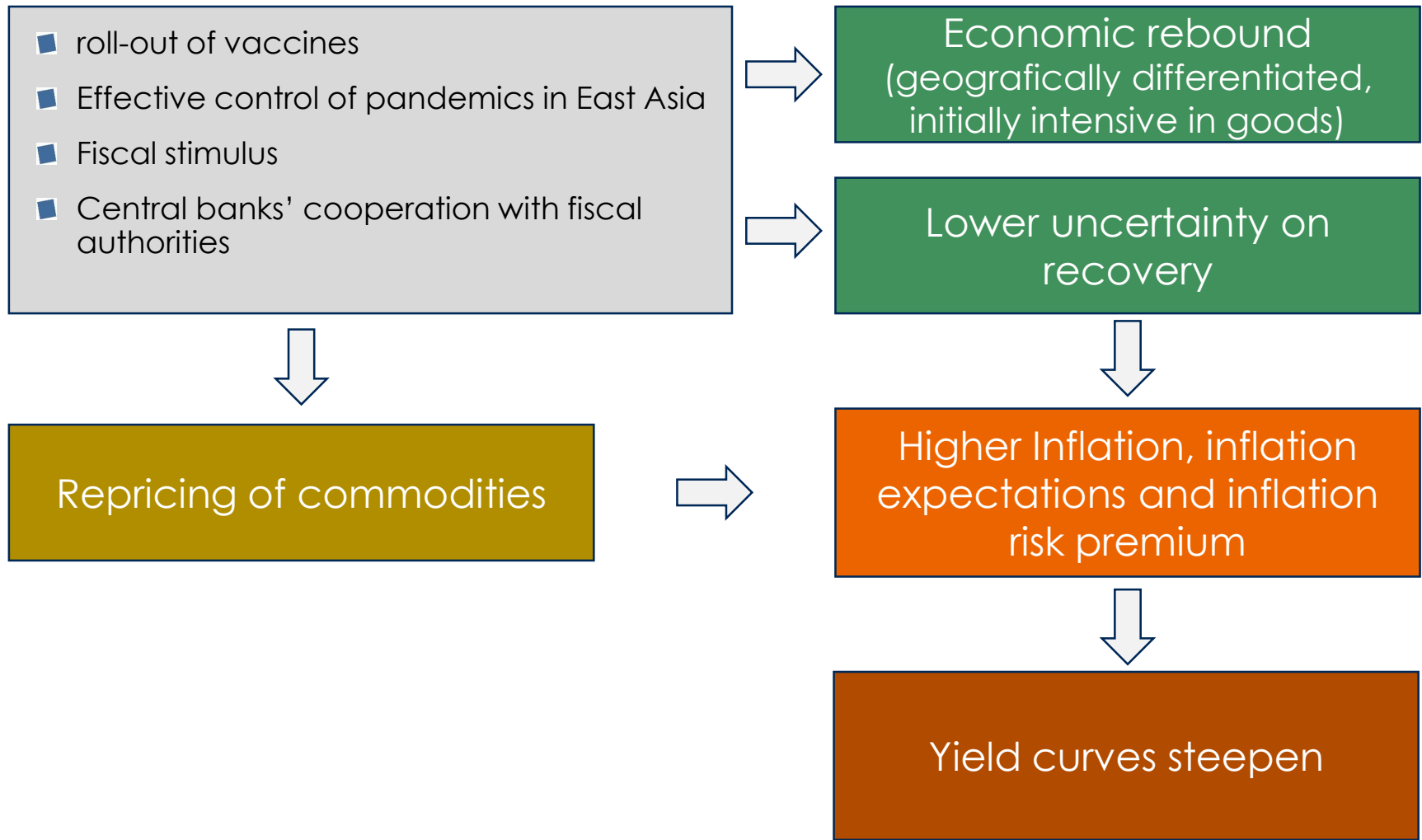
The euro area limps along the recovery path

Italy: risks in the s/t, opportunities in the medium run

The U.S.: undisputed leader in the pandemic race

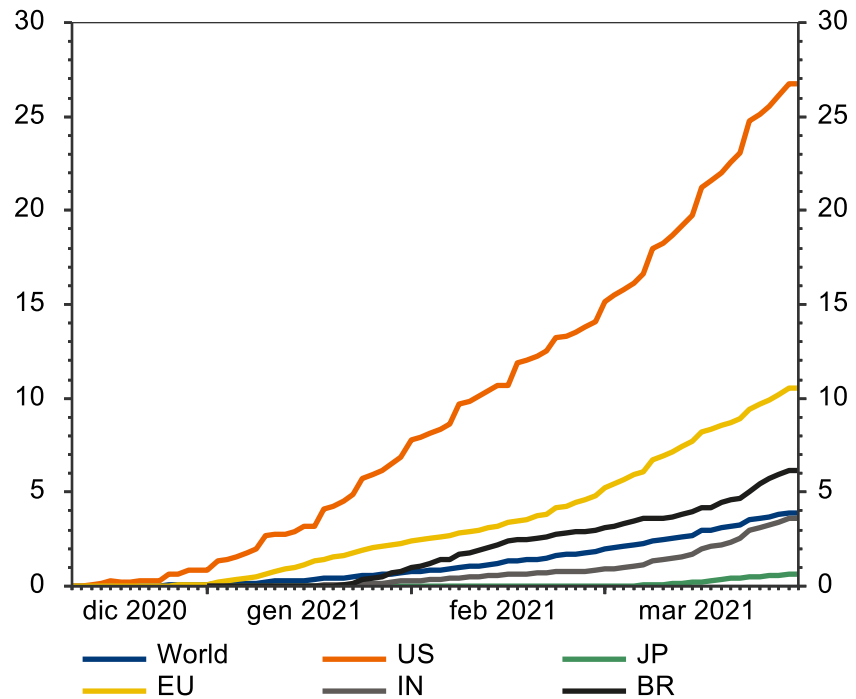
Interest rate outlook

The global macroeconomic picture: a shot in the arm



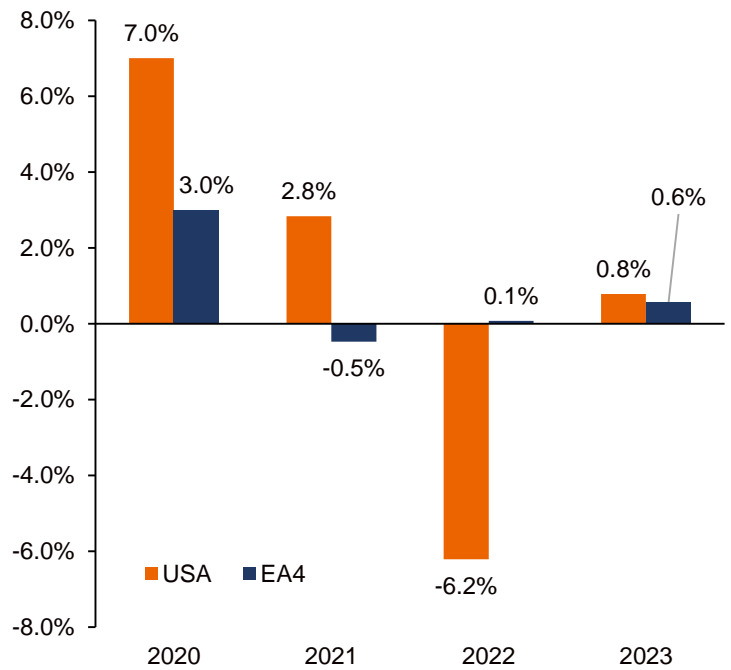
The game changers? Fiscal support and, above all, vaccines

% of vaccinated population



Source: OurWorldInData

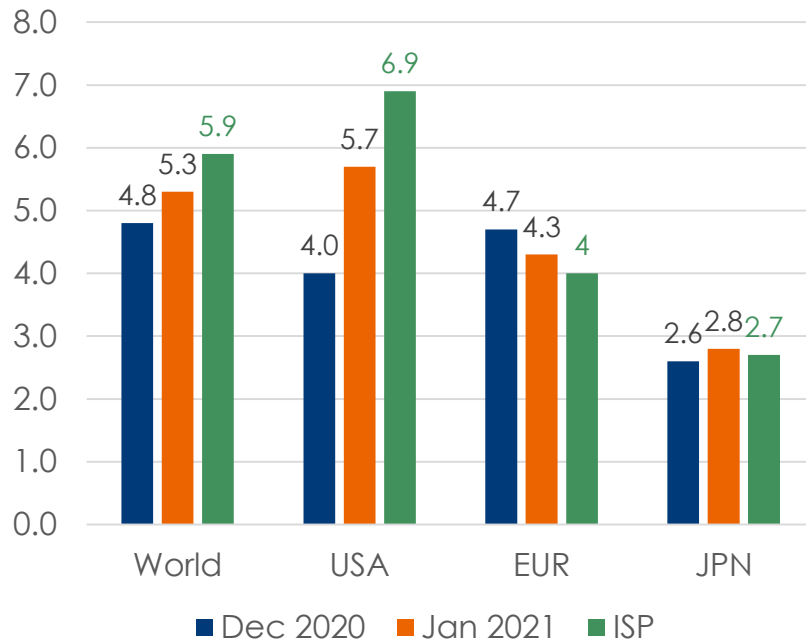
Government transfers to personal sector (% of disposable income)



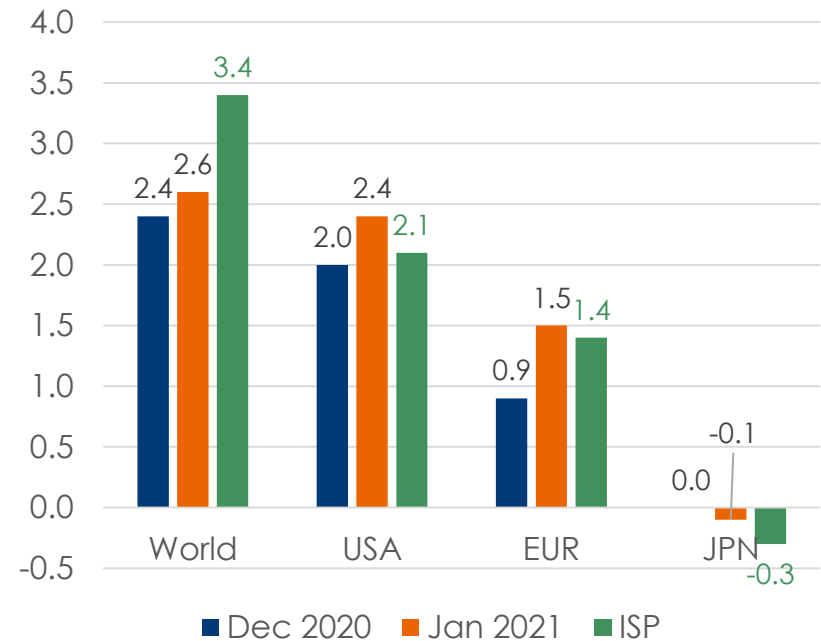
Source: Intesa Sanpaolo Macroeconomic Analysis. Data as % of household disposable income of the year before.

GDP and inflation forecasts move upwards

GDP (2021)



Inflation (2021)

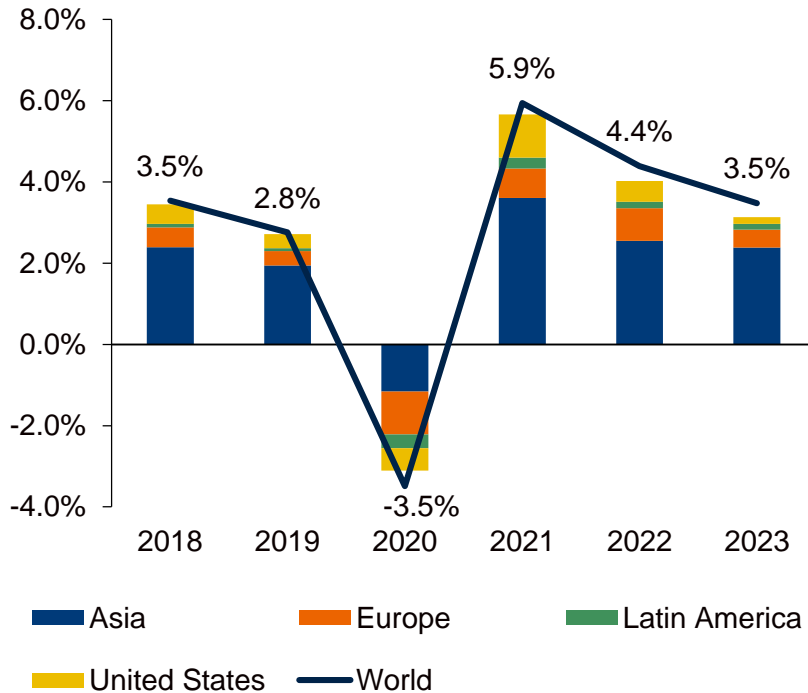


Source: Consensus Economics and Intesa Sanpaolo

Source: Consensus Economics and Intesa Sanpaolo. The definition of CPI for the World aggregates are not fully comparable

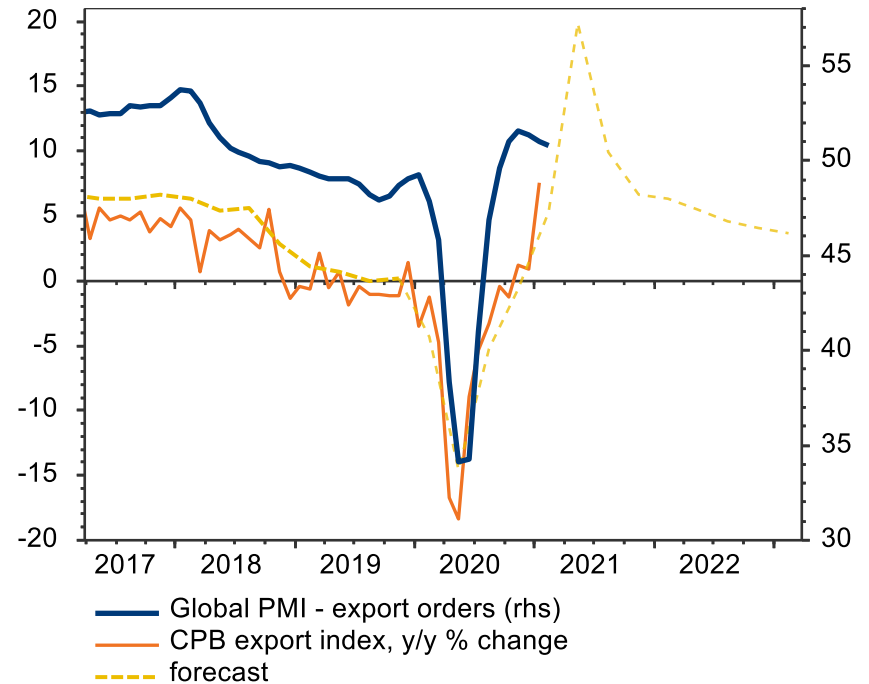
2021: the global GDP rebound is driven by Asia and by the US

Global recovery driven by East Asia and the US in 2021. Eurozone to catch up later



Source: Intesa Sanpaolo Macroeconomic Analysis

The recovery of global trade is V-shaped



Source: CPB, IHS Markit and ISP forecasts

The inflation scare of 2021: a perfect storm

Short-term factors

- Sharp rebound of commodity prices after steep 2020 fall
- Issues with seaborne freight and port congestion after 1° pandemic wave (containers, especially, in Europe and US)
- Excess demand for semiconductors
- Local distortions (VAT in Germany, HICP weight changes in Eurozone, modified seasonality etc.)

The Ever Given container-carrier stranded in the Suez Canal at the end of March 2021.

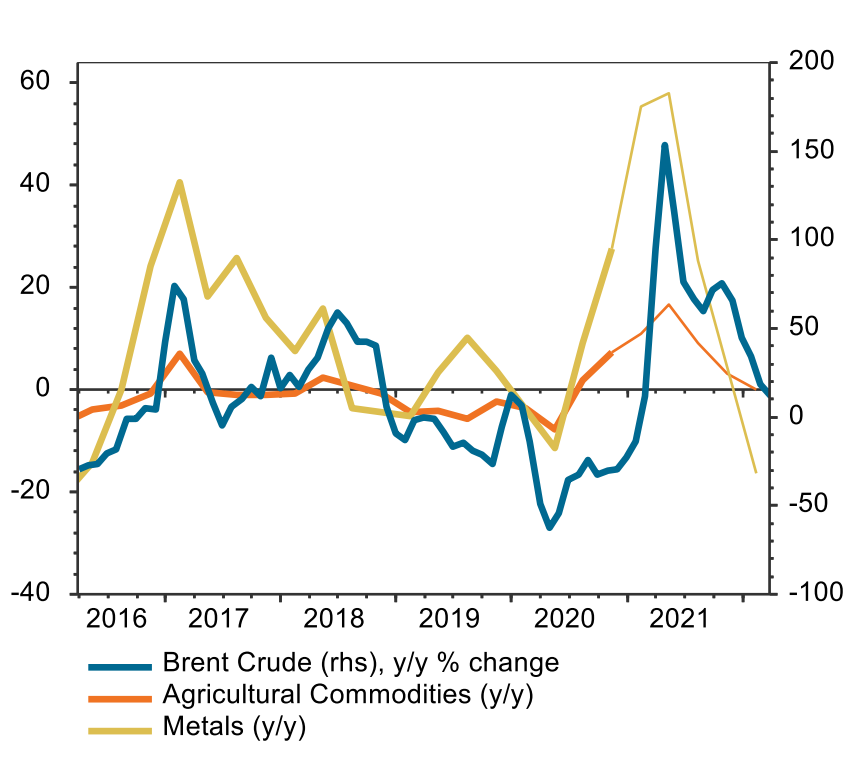


Cyclical and structural factors

- Gradual exhaustion of spare capacity and excess unemployment with post-pandemic rebound (but less than in pre-covid forecasts, and in Europe there is a lot of underemployment, too...)
- Recycling of excess savings accumulated during the pandemic
- Excess demand in some industries, by-product of changes in structure of consumer spending
- Commitment by central banks to allow inflation over target for some time may raise inflation expectations and risk premia (but central banks failed to raise inflation before the pandemic...)
- (possibility of) fiscal dominance of monetary policy: fiscal policy may create excess demand and central banks may fail to tighten monetary policy for fear of causing refinancing problems

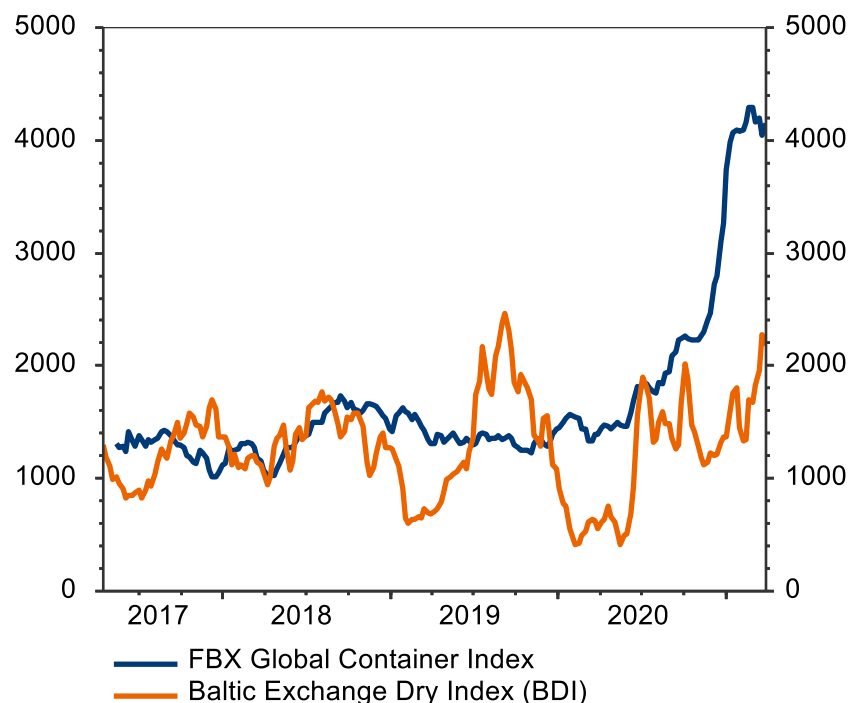
Prices: strong upward pressure on non-labour costs, but it will fade in 2021H2

The recovery story has fuelled a spike in commodity prices...



Source: Refinitiv and ISP forecasts

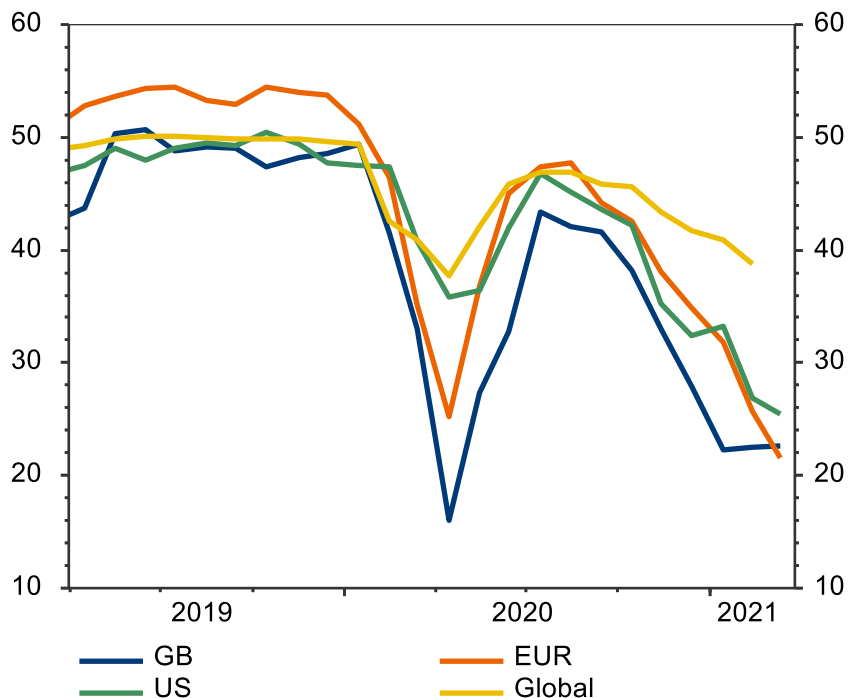
...while the 1st pandemic wave left a troublesome legacy in maritime transports



Source: Freightos, Refinitiv

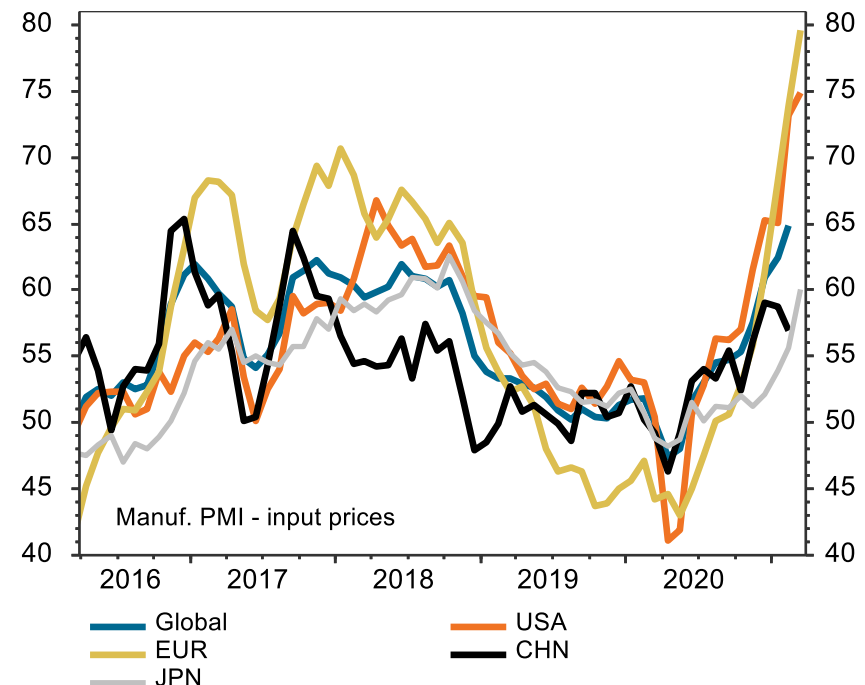
Input prices are rising, as delivery times

Sharply longer delivery times in Europe and US...



Source: IHS Markit. Lower levels of the diffusion index imply longer delivery times

...with widespread increases in input prices

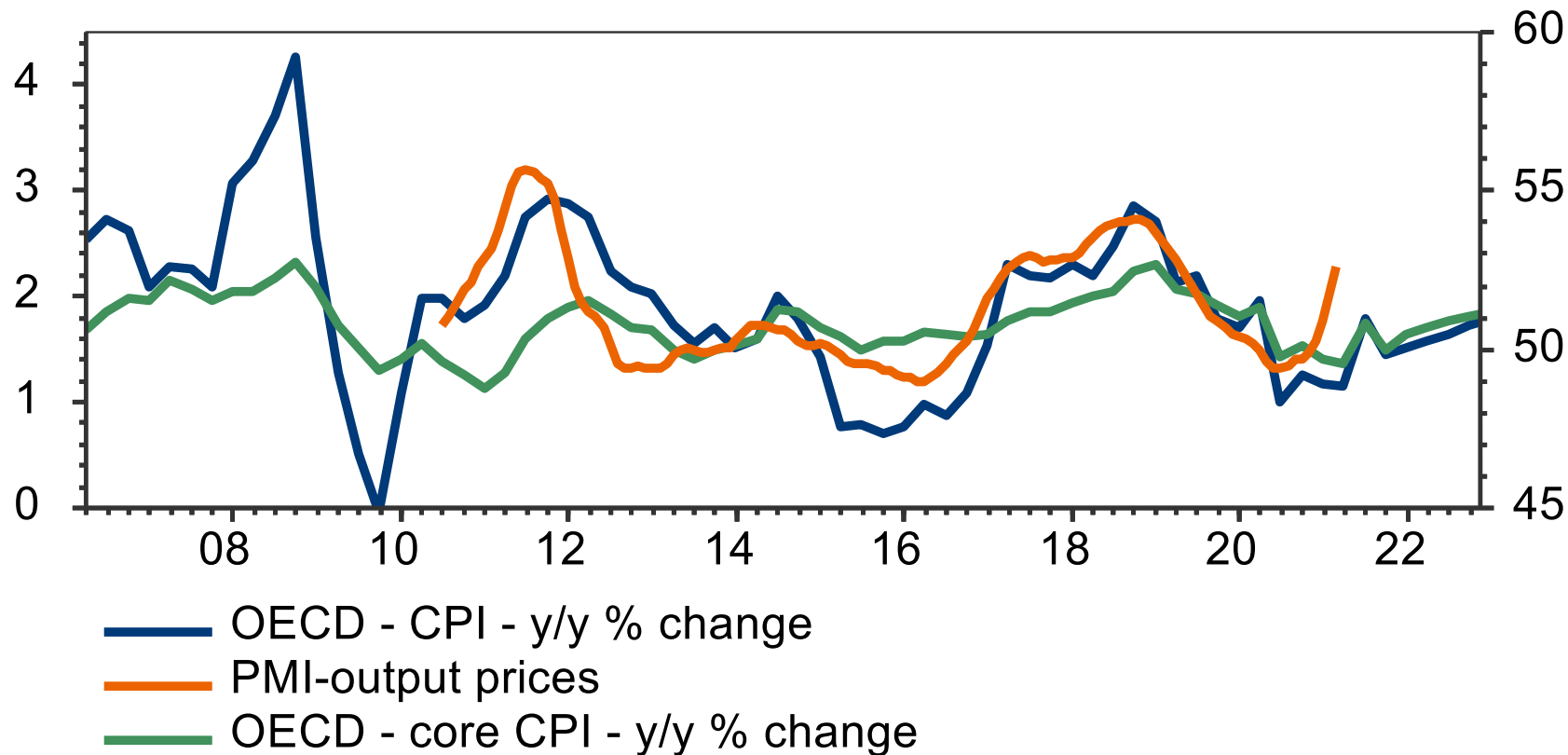


Source: IHS Markit

Small global inflation spike in the making

In our baseline scenario, inflation peaks in 2021, then drops in 2022 and returns to a moderate upward-sloping trend

Global PMI index for prices consistent with inflation > 2% for OECD countries

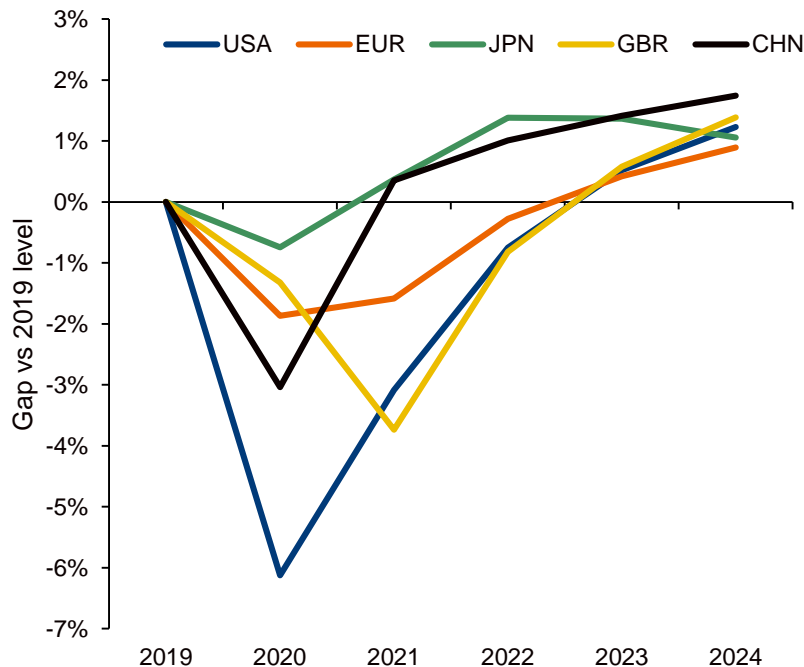


Source: OECD Economic Outlook, IHS Markit. Note: in this chart, projections are OECD's, not Intesa Sanpaolo

The longer-term inflation picture: moderate uprise...

While in the short-term the economy is subject to prevailing downside risks, in the longer run there are also upside risks in relation to fiscal policy and excess savings, not just downside risks. But this are rather country-specific.

The employment gap may persist until 2023...



Source: Intesa Sanpaolo estimates and projections

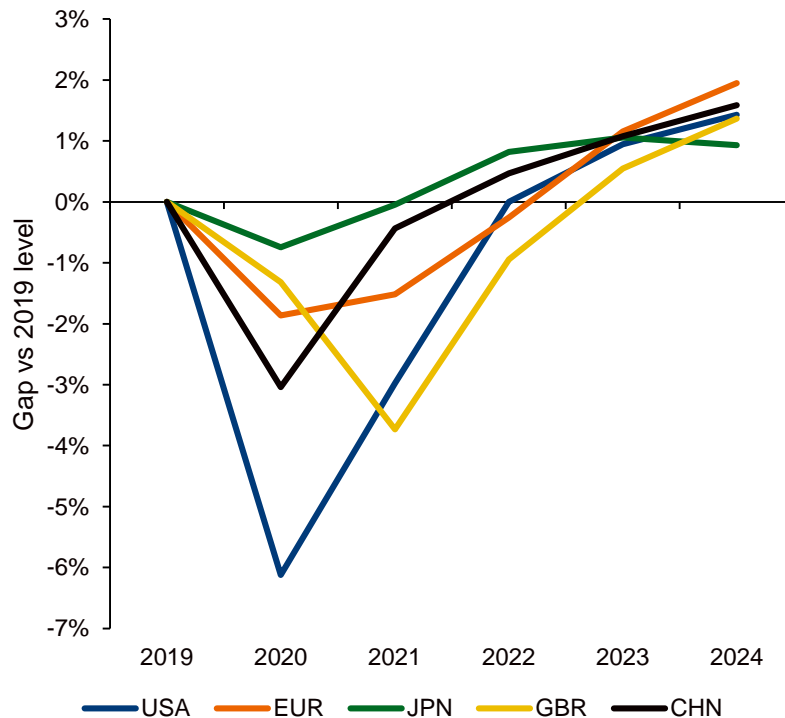
..but what if the savings rate returns to pre-crisis levels more quickly?

	Cumulated excess savings			Increase in PCE with sudden normalization of savings rate		
	2020	2021	Total	2022	2023	2024
	€ Bn	€ Bn	€ Bn	% of 2019 PCE		
USA	1354	943	2297	17%	-1%	-2%
EUR	485	439	924	14%	4%	3%
JPN	199	56	254	10%	0%	0%
GBR	160	76	236	15%	1%	2%
Total	2197	1514	3711	15%	0.2%	-0.1%

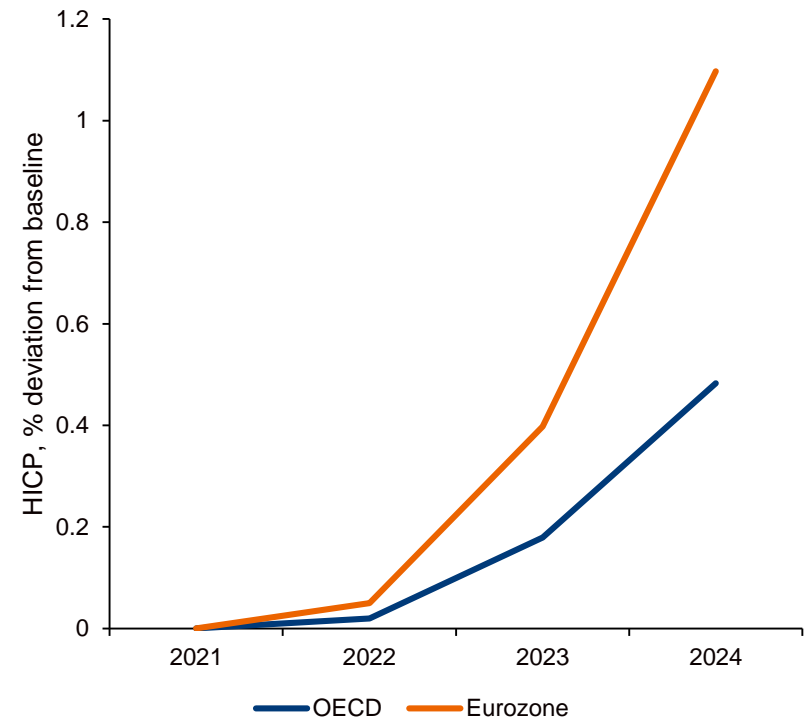
Source: Intesa Sanpaolo estimates and projections

...but a stronger rebound may lead to more inflation

Stronger government investment or a quicker normalization of the savings rate may fill the employment gap faster...



...and raise inflation more than in the baseline



Source: Intesa Sanpaolo estimates and projections

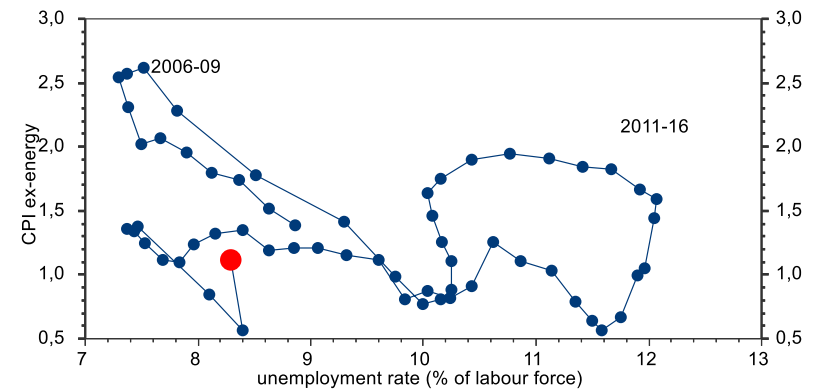
The simulation assumes that the savings rate converges to pre-crisis levels by mid-2023. In the US, government investment is 2.5% higher over the simulation period with no offsetting increase in taxes. Policy rates are left free to adjust.

However, the Phillips curves look rather flat. Why should they get steeper?

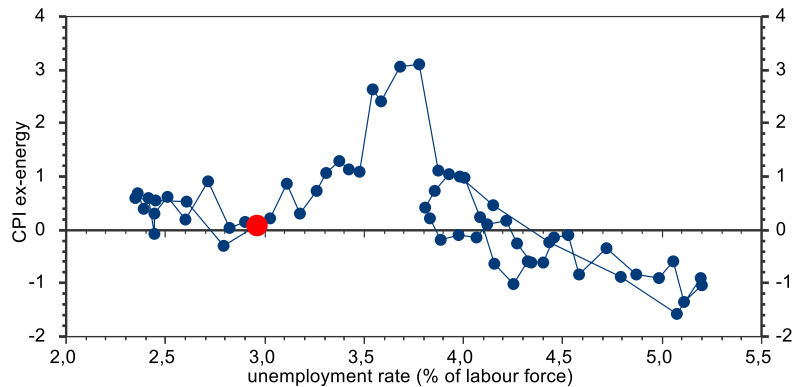
United States



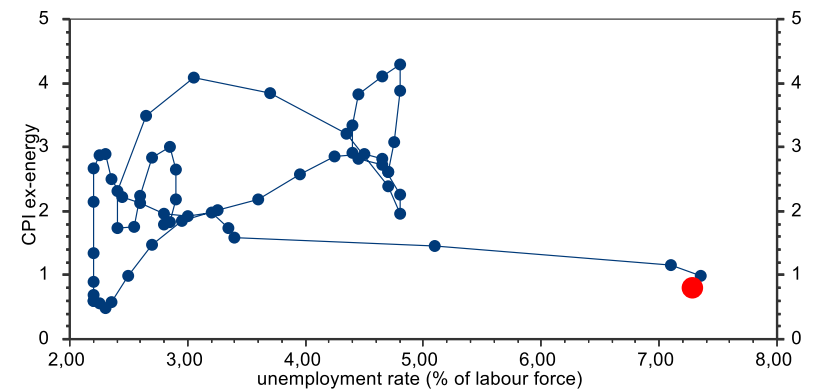
Eurozone



Japan



UK



Source: ISP calculations on Refinitiv and Oxford Economics data. Note: unemployment rate is a 2Q average. The red dot indicates the last observation (2020Q4).

The perfect inflation storm of 2021



The euro area limps along the recovery path

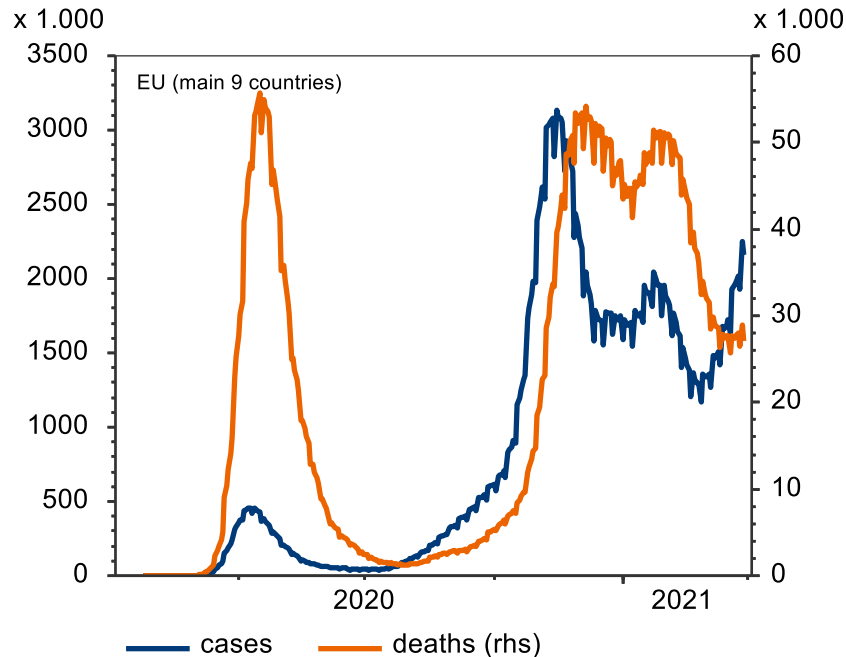
Italy: risks in the s/t, opportunities in the medium run

The U.S.: undisputed leader in the pandemic race

Interest rate outlook

EU governments' pandemic mismanagement

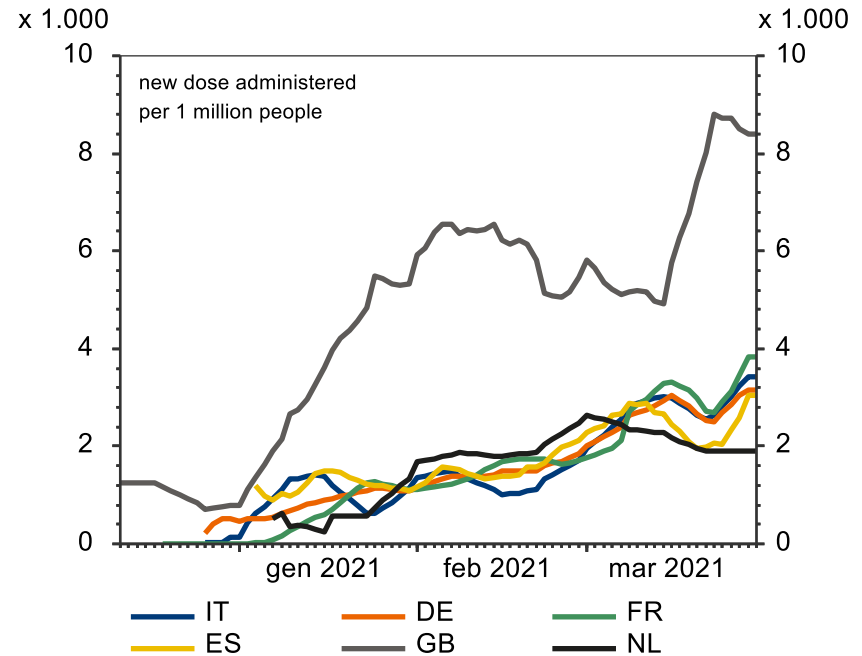
Containment measures? Too late, everywhere



Source: WHO

Note: the aggregate includes the 9 most populous member states of the EU.

The vaccination campaign is still very slow. Herd immunity may slip to Q4, although the health system may achieve resilience much earlier

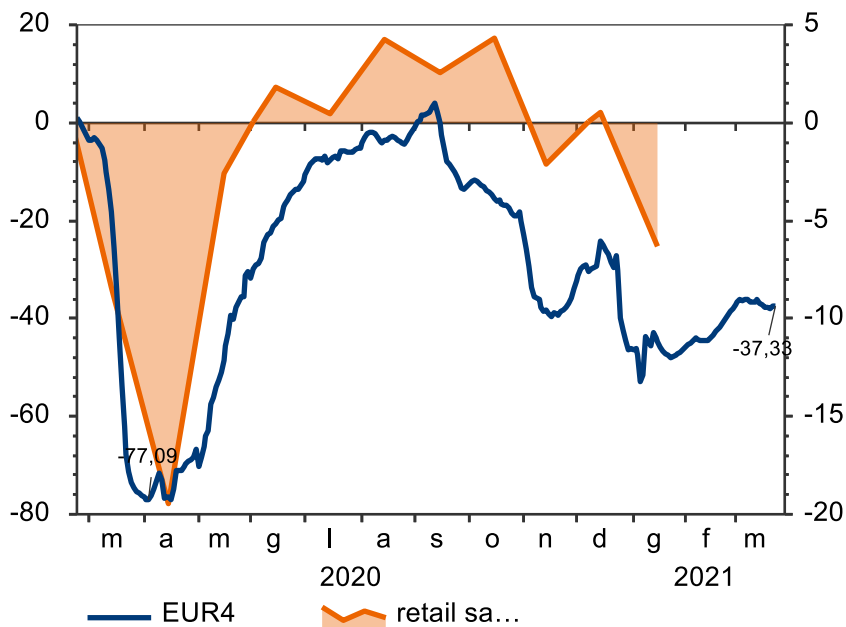


Source: OurWorldInData

One more quarter of shrinking GDP

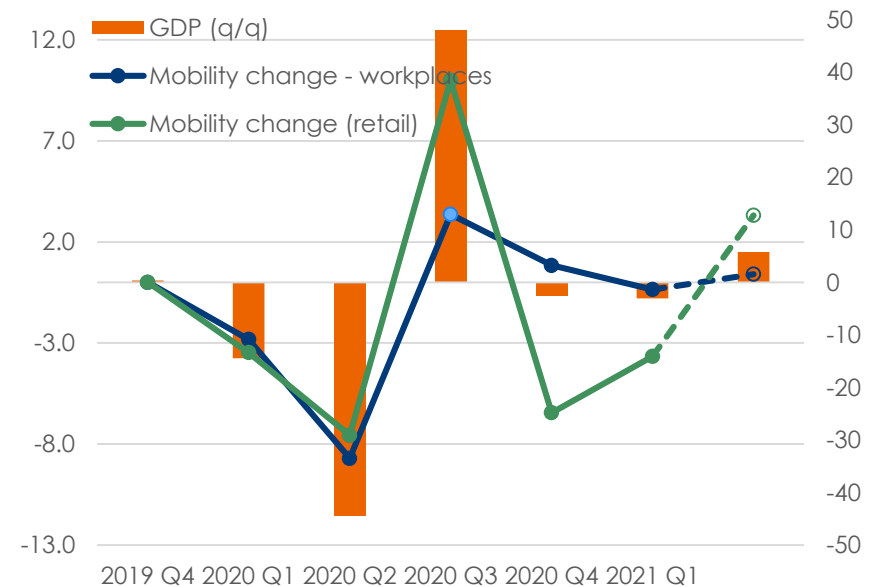
The restrictions were on average tougher in 2021Q1 than in 2020Q4: the first quarter of 2021 will still be slightly negative. Rebound expected from Q2.

Retail trade: impact of restriction in Q1 about the same as in Q4 2020



Source: Eurostat and Intesa Sanpaolo elaborations on Google Mobility Report data

The easing of restrictions in Q2 will lead to a rebound

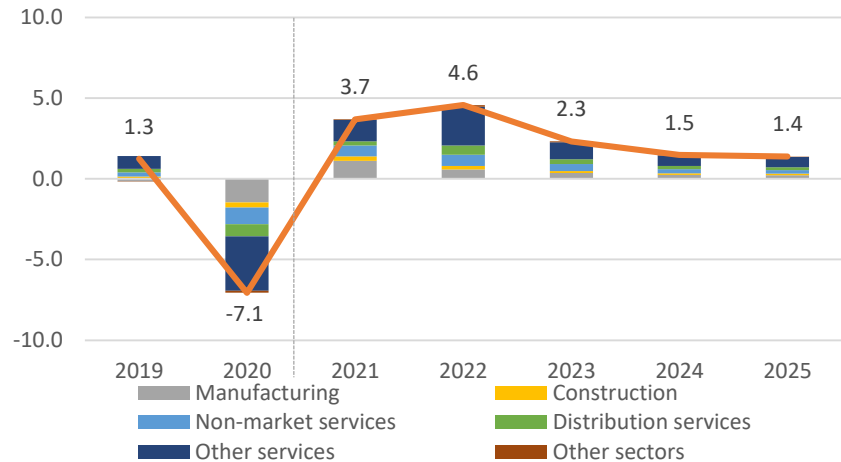


Source: Intesa Sanpaolo calculations and forecasts on Google Mobility Report and Eurostat data

The economic outlook of the euro area

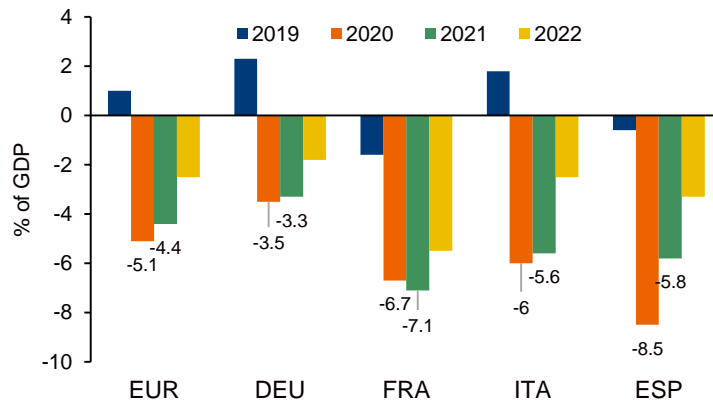
- The economy will become more resilient against contagion waves with the immunization of the elderlies, but full normalization is unlikely this year.
- GDP growth 4.0% in 2021, rising to 4.5% in 2022. Pre-crisis levels to be recovered by mid-2022
- Retail trade, services will catch up with manufacturing and construction from Q2 onwards

Valued-added, y/y % change and contribution by sector



Source: Intesa Sanpaolo projections on Eurostat data

Government primary balance, % of GDP



Source: Intesa Sanpaolo projections on European Commission data

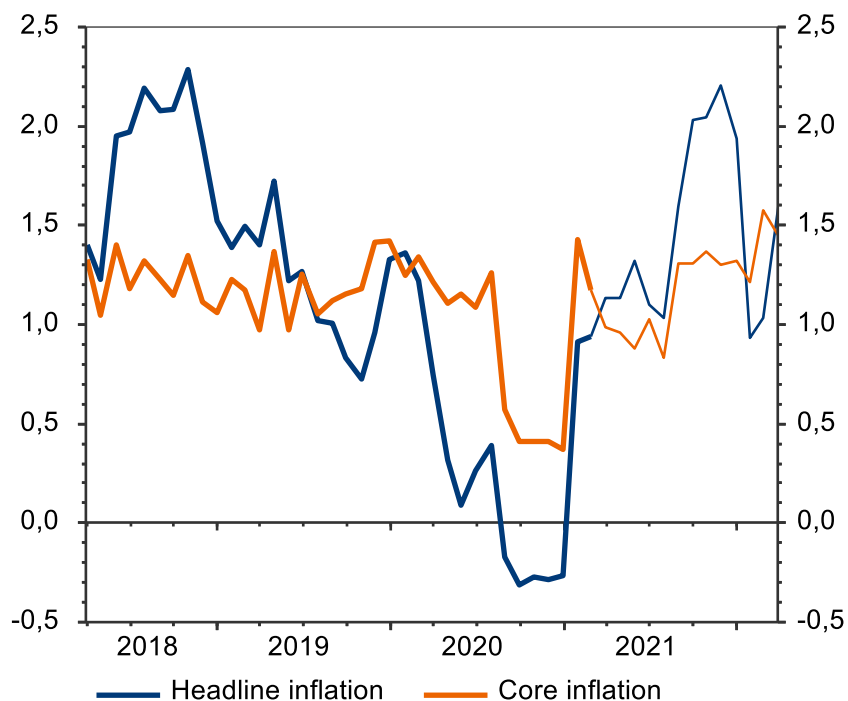
- Key drivers of growth: vaccinations, foreign demand, supportive fiscal policy
 - impact of revisions to US GDP about 0.2%
 - Fiscal stance supportive in 2021. Improvement entirely related to lower emergency spending
 - No impact of NGEU in 2021, but public investment will probably rise all the same

Inflation spikes in 2021, then back to a moderately rising trend

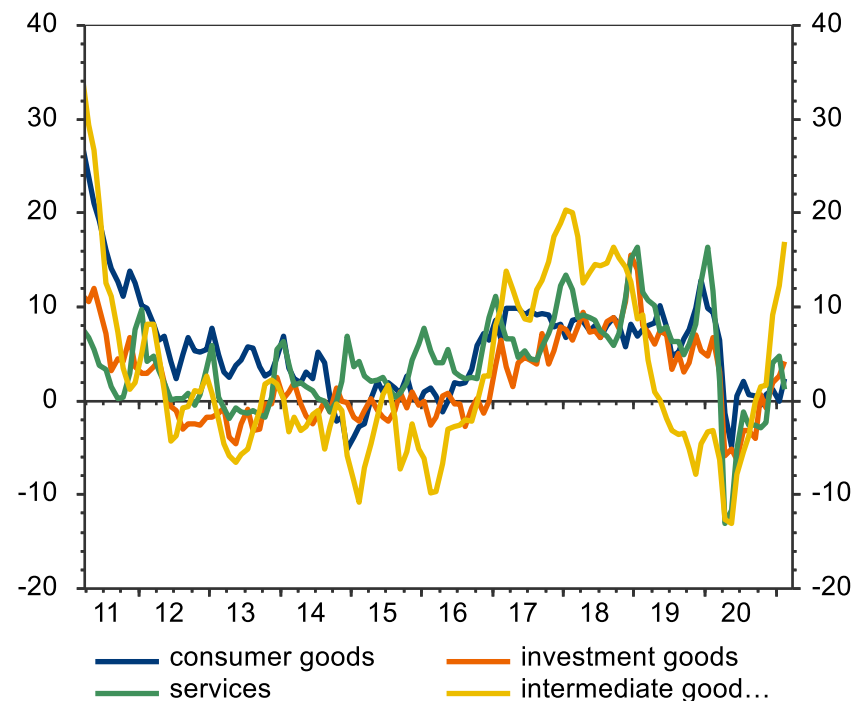
Headline inflation may peak at more than 2% in Q4 and then drop back. Underlying inflation will rise to 1.6-1.7% with the strengthening of economic recovery in 2022-23.

Transitional factors will push inflation towards 2% at the end of the year, but for a short time

The upward pressure on sell prices reported by surveys are still largely confined to intermediate goods



Source: Eurostat and Intesa Sanpaolo projections



Source: European Commission

ECB to become more tolerant of higher rates from Q3

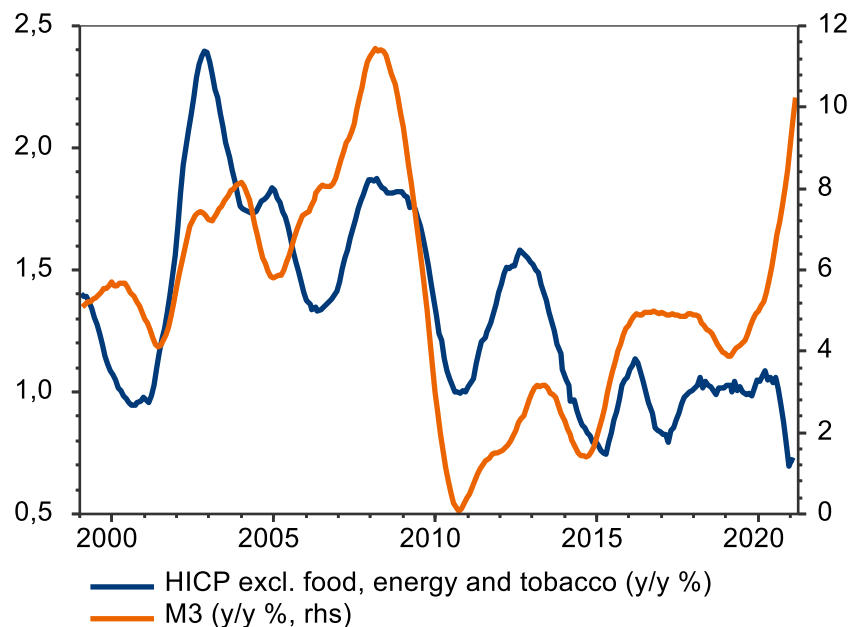
- The ECB has raised the net purchases under the PEPP, in order to prevent an 'unwarranted' tightening of financing conditions.
- However, the ECB stresses they are not targeting specific levels of rates and that their tolerance is scenario-dependent.
- ECB does not believe in medium-term inflation spike: forecast is just 1.4% in 2023.

- Our forecasts:
 - Net PEPP purchases will be scaled back in Q3
 - PEPP net purchases will end in March 2022
 - APP net purchases to continue until mid 2023
 - Scenario consistent with first rate hike in early 2024
 - End to reinvestment of maturities not in forecast horizon

Booming money aggregates are more of a threat to financial stability than to price stability

The expansion of money aggregates is related to an increase of liquid balances held by nonfinancial firms and households. The latter reflects a shift out of debt securities.

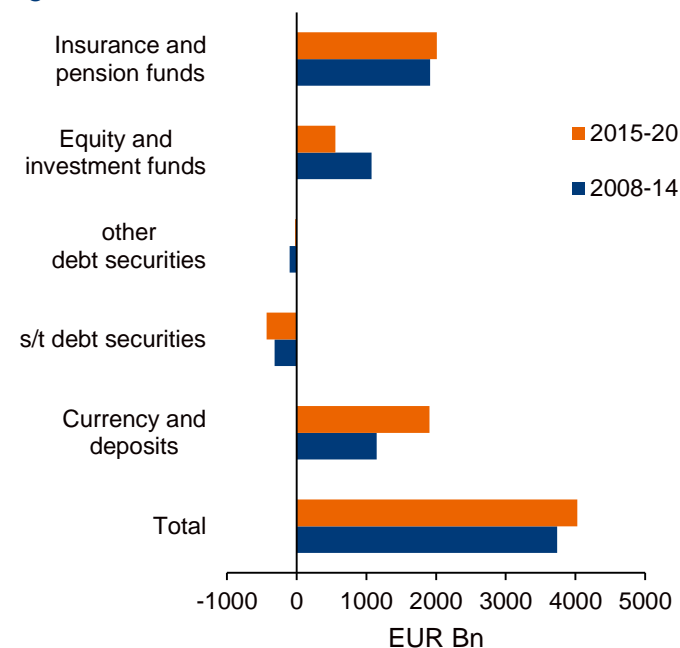
Euro area: booming M3...



Note: 12-month moving averages. Source: Intesa Sanpaolo calculations on ECB and Eurostat data

... but the increase in money holdings by households reflects a change in asset allocation in a context of low yields

Change in the financial assets of the household sector



Source: calculations from ECB data

Euro area – baseline forecast

	2020	2021f	2022f	2020				2021p				2022p	
				1	2	3	4	1	2	3	4	1	2
GDP (constant prices, y/y)	-6.8	4.0	4.5	-3.3	-14.6	-4.2	-4.9	-2.0	12.5	2.2	4.4	6.1	5.3
- q/q change				-3.8	-11.6	12.5	-0.7	-0.8	1.5	2.2	1.4	0.8	0.7
Private consumption	-8.1	2.0	3.9	-4.5	-12.6	14.1	-3.0	-1.1	1.5	1.5	1.8	0.6	0.5
Fixed investment	-8.5	6.3	4.6	-5.9	-16.1	13.9	1.6	0.5	1.2	2.3	1.9	0.7	0.6
Government consumption	1.1	2.8	1.3	-0.3	-2.2	4.6	0.4	0.2	0.3	0.5	0.4	0.2	0.3
Export	-9.8	9.5	5.2	-3.7	-18.8	16.7	3.5	0.8	2.5	2.3	1.9	0.9	0.6
Import	-9.3	7.4	4.7	-2.9	-18.2	11.8	4.1	1.0	1.9	2.0	1.7	0.8	0.6
Stockbuilding (% contrib. to GDP)	-0.2	-0.3	0.8	0.5	0.0	-1.5	0.6	-0.3	0.0	0.6	-0.2	0.2	0.3
Current account (% of GDP)	2.6	2.6	2.7										
Government Balance (% of GDP)	-7.2	-6.2	-3.6										
Government Debt (% of GDP)	99.6	101.8	100.2										
HICP (y/y)	0.3	1.4	1.6	1.1	0.2	0.0	-0.3	1.0	1.2	1.6	2.1	1.2	1.9
Industrial production (y/y)	-8.7	9.5	4.0	-6.1	-20.2	-6.9	-1.6	4.3	24.1	7.9	4.2	2.8	3.8
Unemployment (%)	7.9	8.4	7.9	7.3	7.6	8.6	8.2	8.2	8.3	8.4	8.7	8.3	7.9
3-month Euribor	-0.42	-0.53	-0.52	-0.41	-0.30	-0.47	-0.52	-0.54	-0.53	-0.53	-0.53	-0.53	-0.52
EUR/USD	1.14	1.17	1.18	1.10	1.10	1.17	1.19	1.21	1.17	1.16	1.16	1.17	1.17

The perfect inflation storm of 2021

The euro area limps along the recovery path



Italy: risks in the s/t, opportunities in the medium run

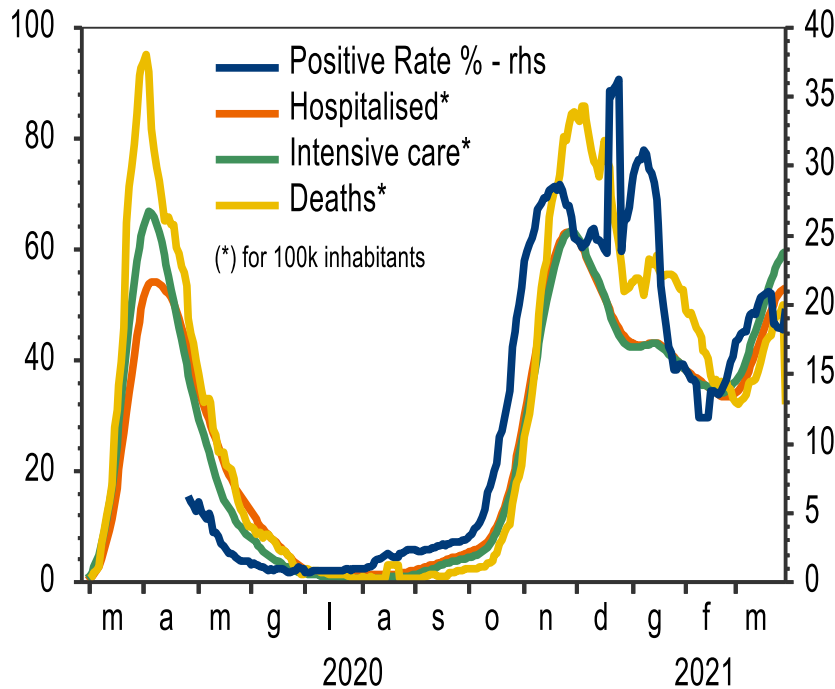
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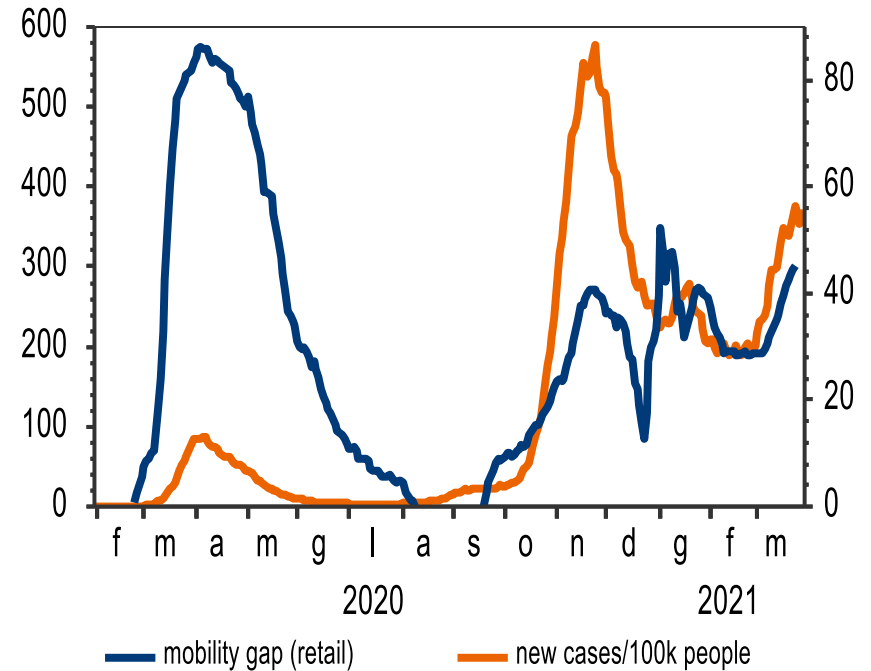
Italy: a «third» wave of COVID is ongoing

A «third» wave of COVID-19 is ongoing...

...also due to the fact that the containment measures put in place in the last 6m were relatively mild



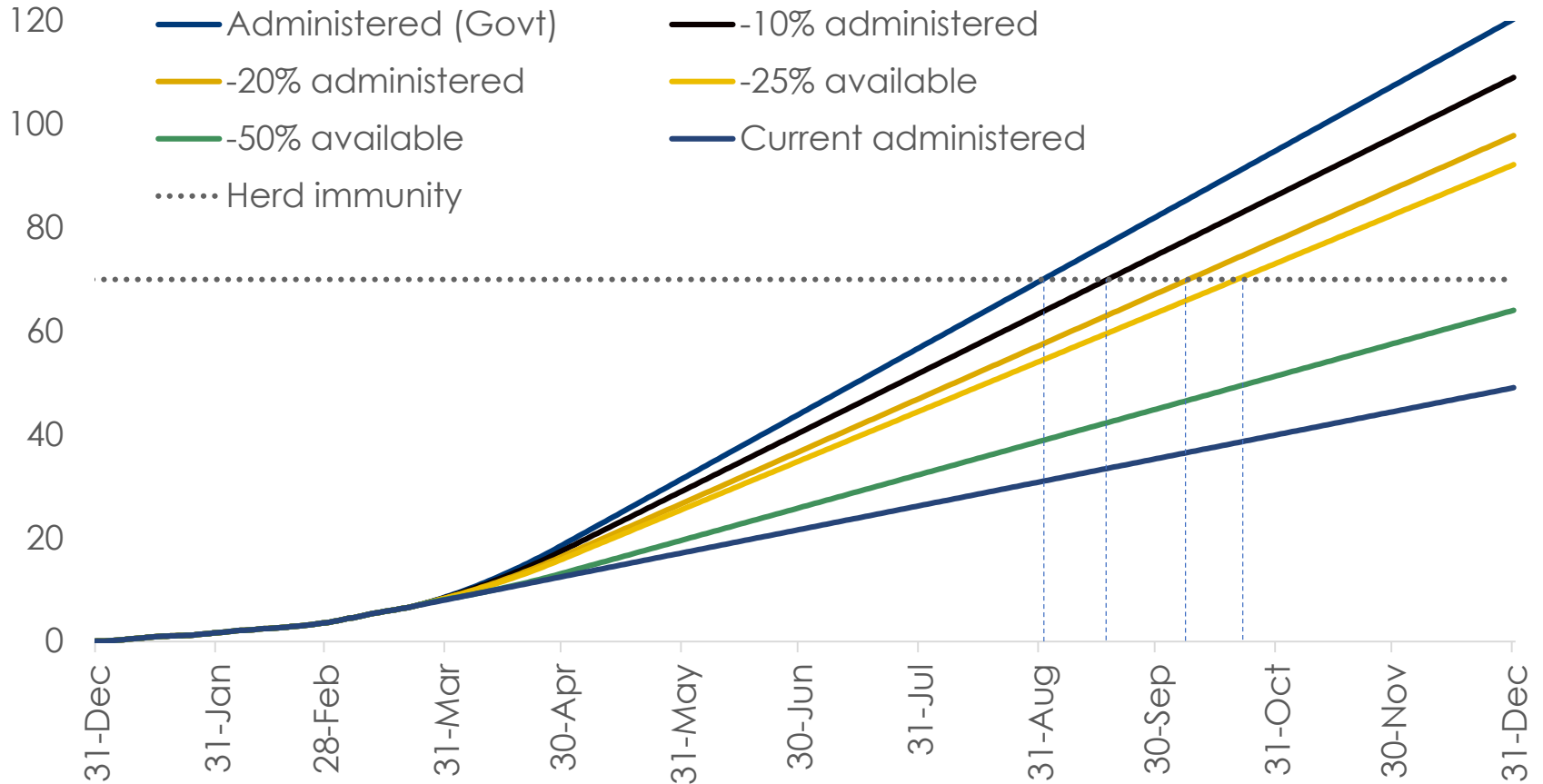
Source: ISP calculations on Italian Civil Protection data



Source: Intesa Sanpaolo elaborations on WHO and Google Community Mobility Report data

Progresses will be linked to vaccines' availability

When will «herd immunity» be reached?

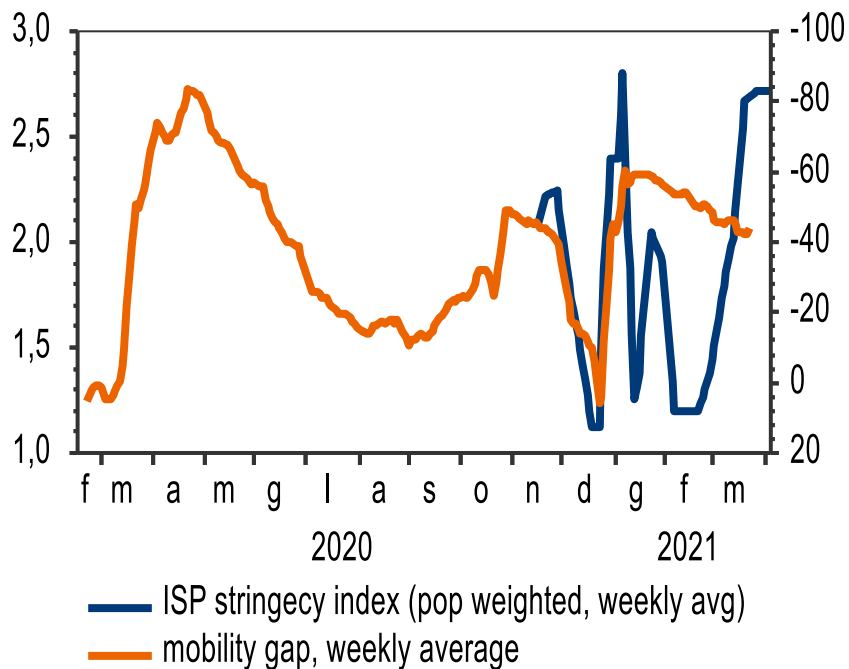


Note: % of immunized population. Source: ISP elaborations based on Italian Govt data

A new tightening is on course, which may weigh on Q2

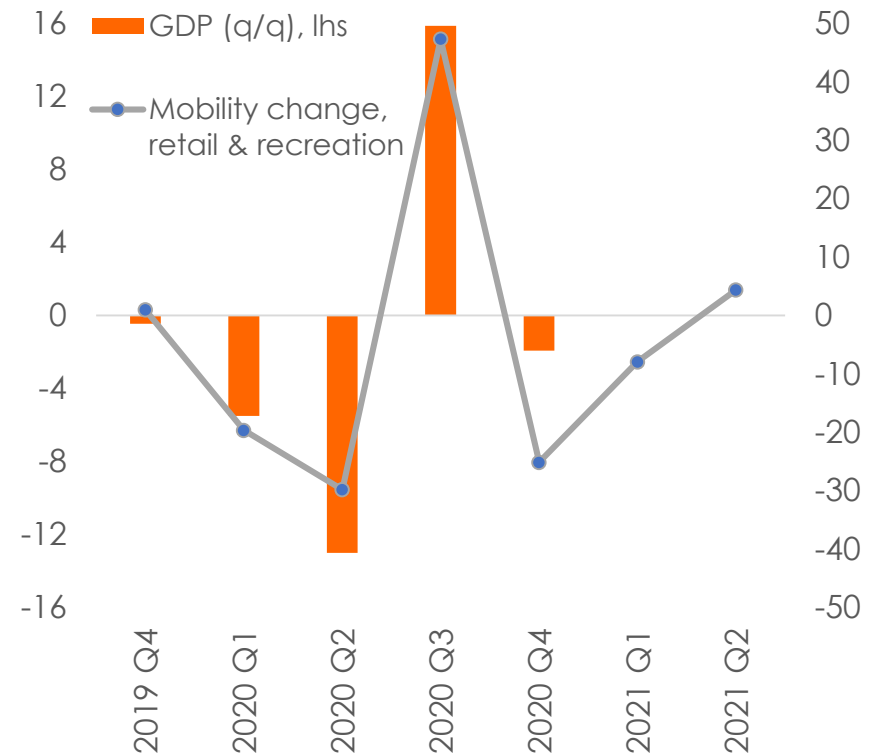
The stringency of measures, currently at its highest since the second wave, has not yet fully reaped its effects on mobility...

...that seem consistent with still negative GDP in 1Q, and only slightly positive growth in Q2 (although risks are skewed to the downside)



Note: 1 = YELLOW AREA (low risk), 2 = ORANGE AREA (intermediate risk), 3 = RED AREA (high risk). Weighted average of regions/provinces based on population

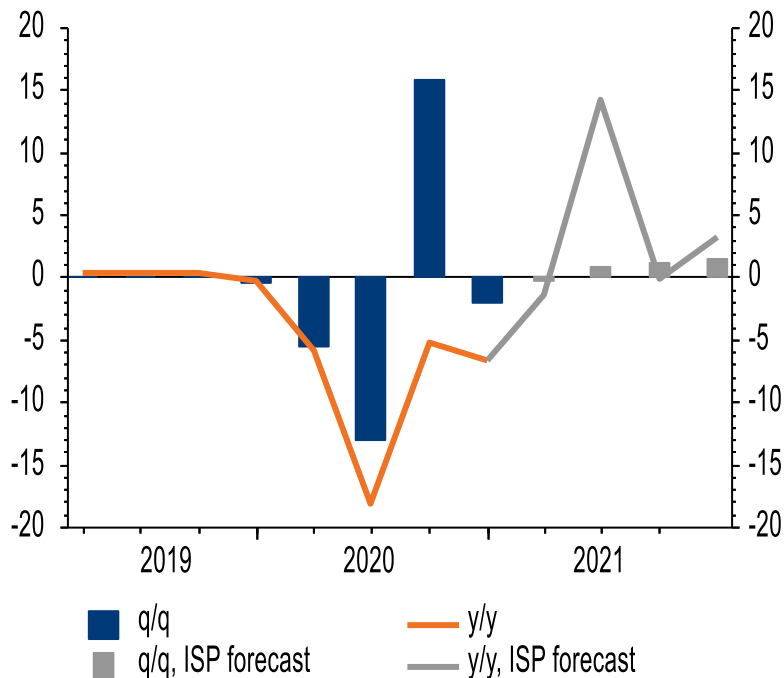
Source: Intesa Sanpaolo and Google Community Mobility Report data



Source: Intesa Sanpaolo elaborations on Istat and Google Community Mobility Report data

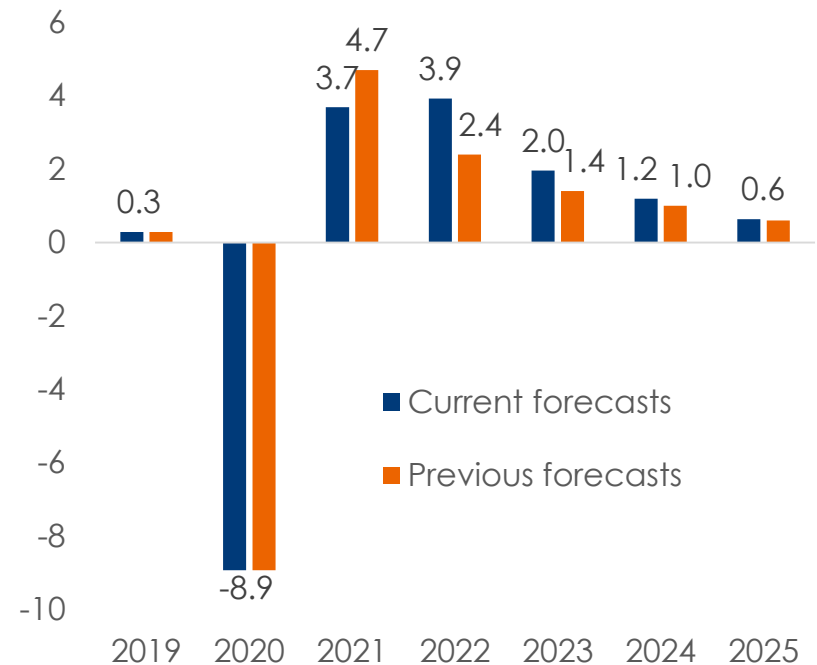
A sizeable rebound is expected only from Q3

A full-fledged recovery, with q/q GDP growth rates in excess of 1%, will only be possible starting in the Summer (assuming that the vaccination campaign speeds up significantly)



Source: Intesa Sanpaolo forecasts on Istat GDP data

We have recently revised down our forecast for GDP in 2021, in light of a weak start to the year, while at the same time raising our forecasts for the following years

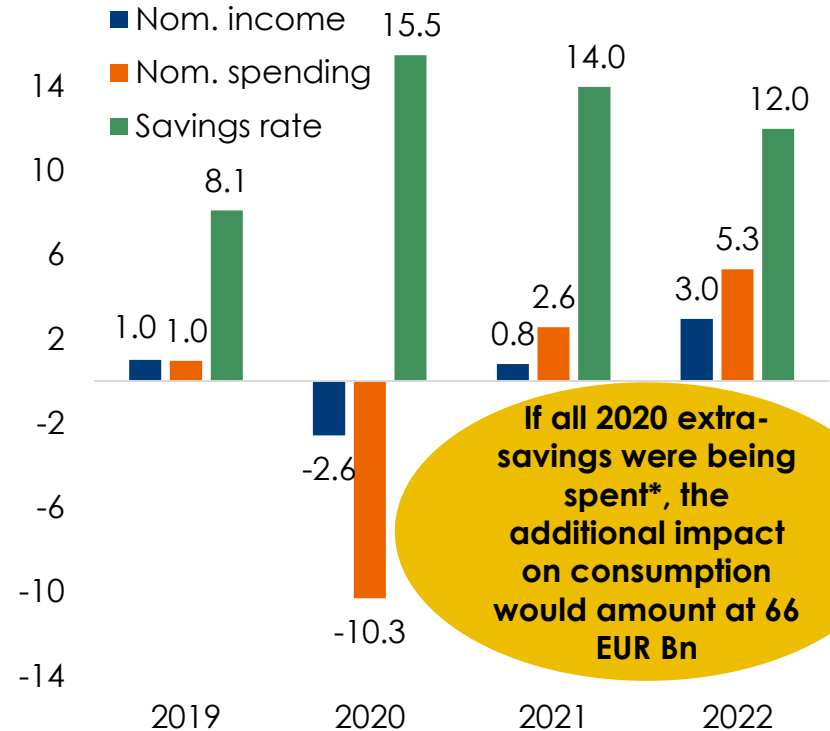
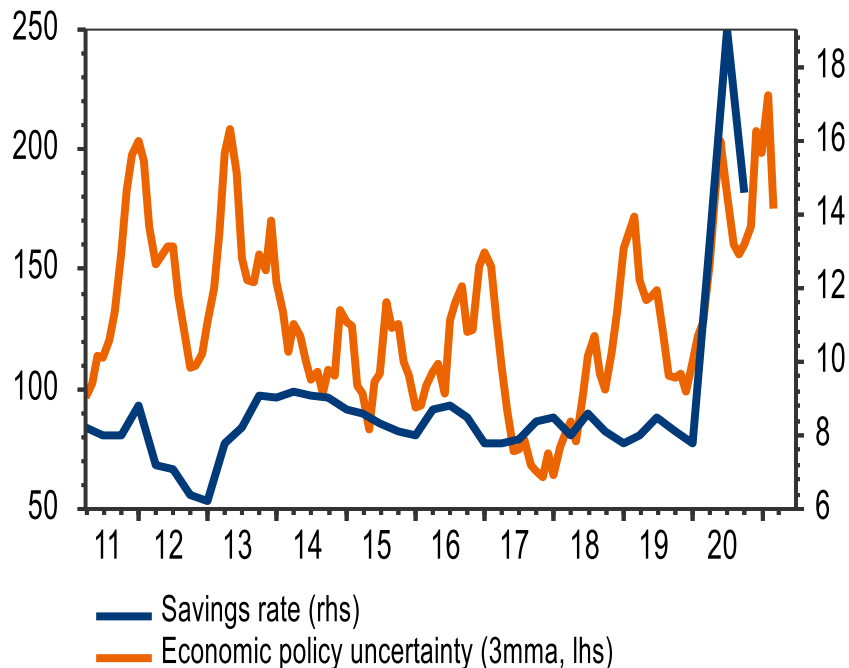


Source: Intesa Sanpaolo forecasts for the y/y % chg. of real GDP

A normalization in the savings rate is crucial

Unlike previous recessions, the present one is accompanied by a surge in the savings rate, due to lingering uncertainty on the evolution of the healthcare and economic picture

Even penciling out a robust increase in spending, the savings rate will remain higher than before the COVID shock

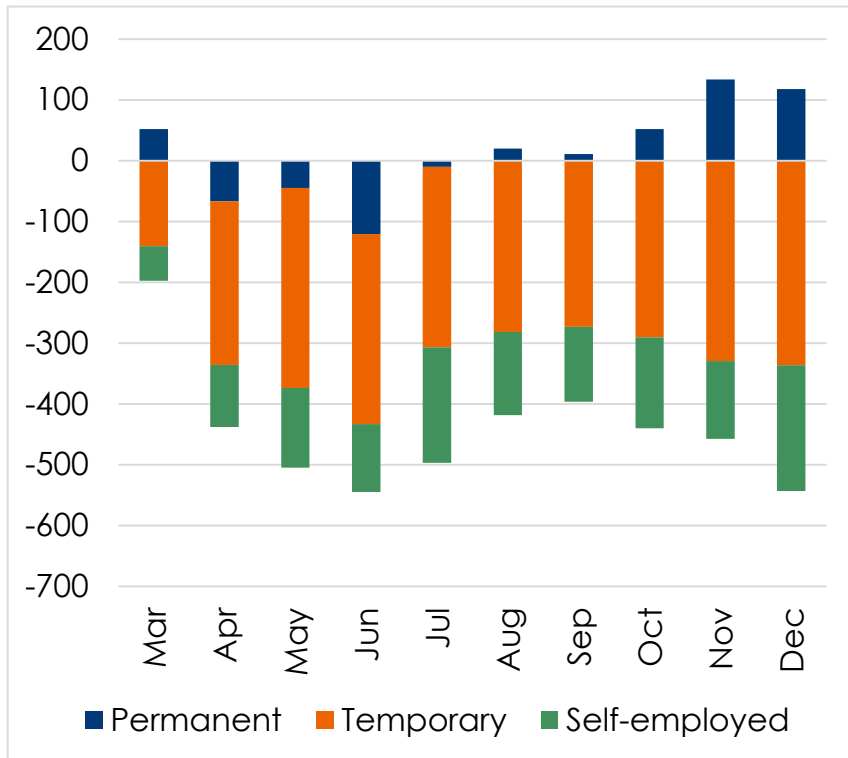


Source: Intesa Sanpaolo elaborations on Istat data and www.policyuncertainty.com

* If the savings rate in 2021 goes back to 2019 level. % y/y change in households' income and spending in current prices, savings rate as a % of disposable income. Source: Intesa Sanpaolo calculations and forecasts on Istat data

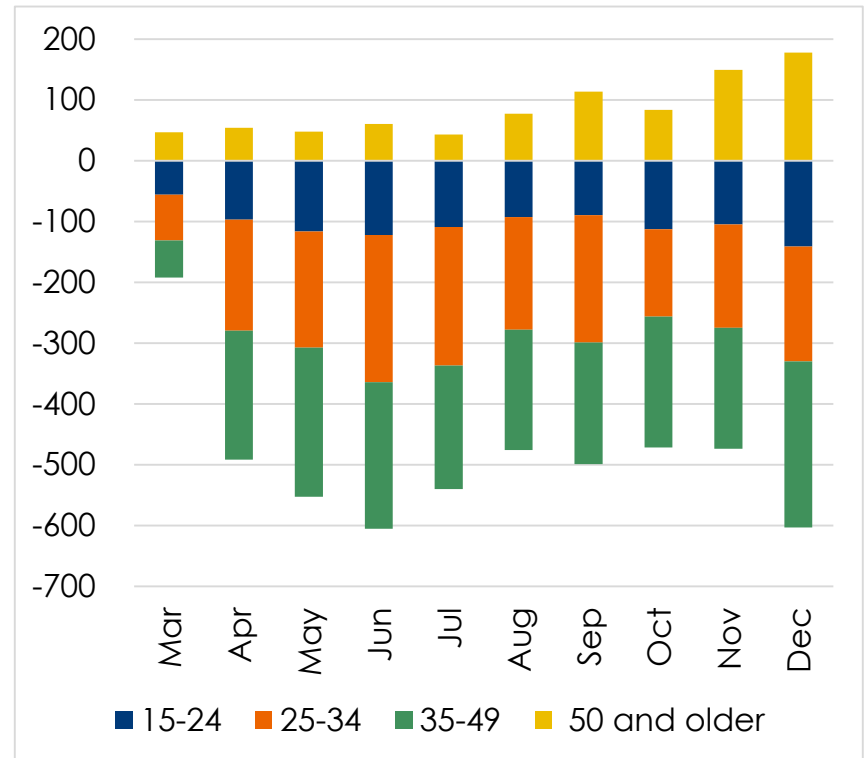
Permanent employees (and older workers) were protected from job losses...

Cumulated changes of employed individuals
by position and type of job since March
(thousand units)



Source: ISP calculations on Istat data

Cumulated changes of employed individuals
by age group since March (thousand units)

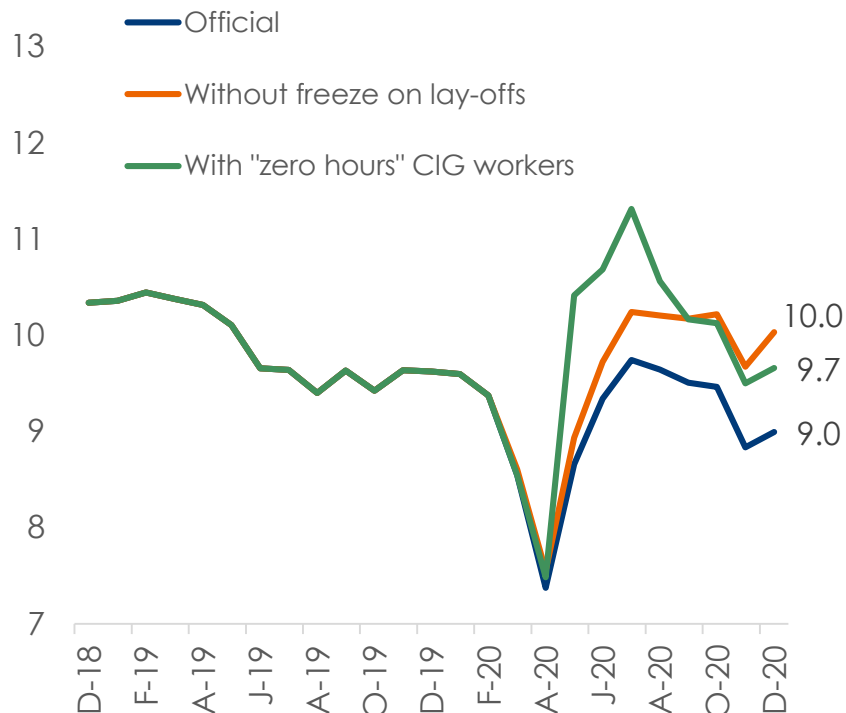


Source: ISP calculations on Istat data

...but expiration of the freeze on layoffs can bite

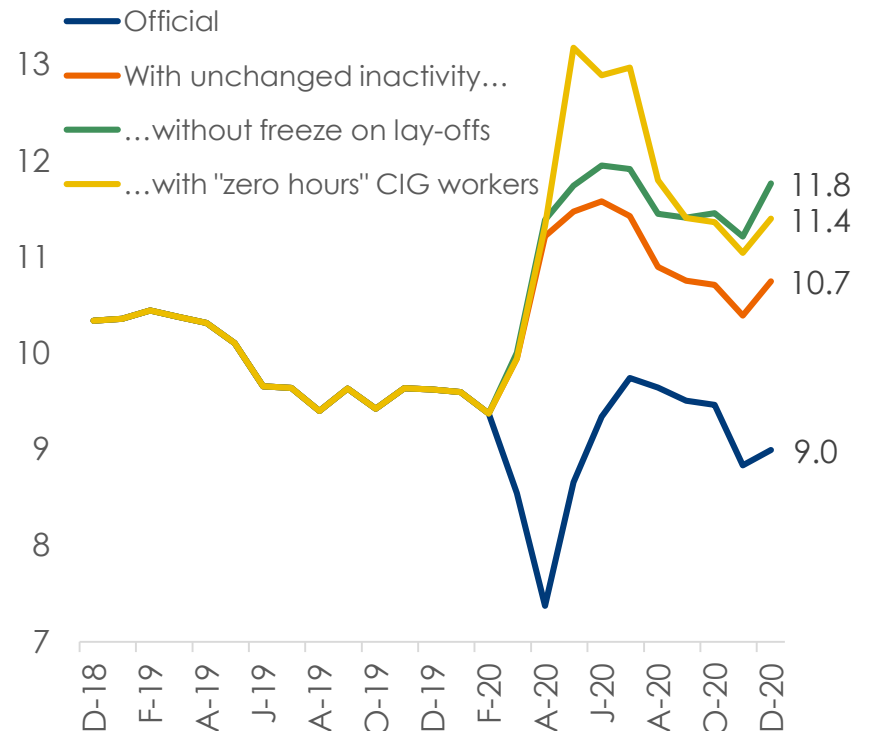
Compared to the pre-COVID levels (February 2020), there are 420k fewer employees and over 400k more inactive people. We continue to believe that **unemployment has ample room for a rise, which for now is limited by the increase in inactivity and the freeze on layoffs**: the peak for the jobless rate can be reached on average for the year not in 2021 but in 2022 (close to 11%).

The unemployment rate would be higher without the freeze on layoffs



Source: Istat, ISP calculations

The effect would be stronger if all the additional inactive workers were considered as unemployed



Source: Istat, ISP calculations

Summary of economic forecasts

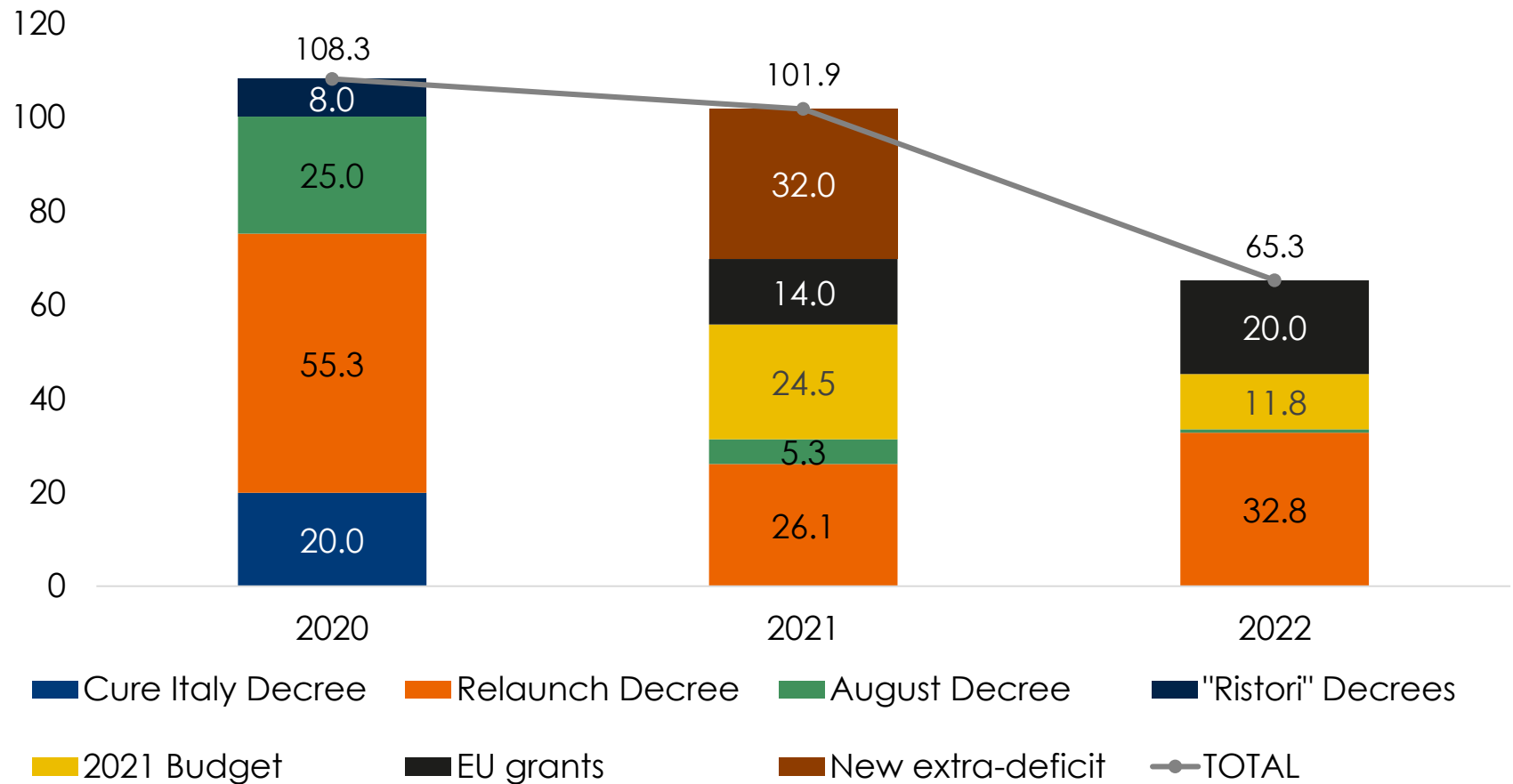
- We have revised downwards our growth forecasts for the Italian economy in 2021, to 3.7%. The downward revision for 2021 stems from a weak start to the year and affects mostly consumption.
- Projections on 2022-23 have been revised upwards (from 2.4% to 3.9% in 2022, from 1.4% to 2% in 2023, and from 1% to 1.2% in 2024), due to:
 - 1) the smaller rebound in 2021 opens a greater margin to return to pre-crisis levels in the following years;
 - 2) the Government change may have an impact on financial conditions, confidence, the vaccination campaign, the country's ability to exploit opportunities offered by the NGEU, and to implement structural reforms.

	2020	2021f	2022f	2020	2020	2020	2020	2021	2021	2021	2021	2022	2022
				1	2	3	4	1	2	3	4	1	2
GDP (constant prices)	-8.9	3.7	3.9	-5.8	-18.2	-5.2	-6.6	-1.3	14.3	-0.2	3.3	4.6	4.5
- q/q change				-5.5	-13.0	15.9	-1.9	-0.2	0.8	1.2	1.5	1.0	0.7
Personal consumer spending	-10.7	2.3	4.1	-7.1	-11.9	13.2	-2.7	-0.3	0.9	1.3	1.5	1.0	0.8
Government consumption	1.6	2.6	0.6	1.4	-1.4	1.6	1.5	0.5	0.4	0.3	0.2	0.1	0.1
Fixed Investments	-9.2	9.6	3.3	-7.9	-17.1	29.1	0.2	0.4	0.6	0.8	0.9	0.9	0.8
Imports	-13.1	9.0	3.5	-5.7	-18.1	14.1	5.4	1.0	2.0	1.4	0.7	0.7	0.7
Exports	-14.5	11.4	4.6	-8.1	-24.3	30.5	1.3	2.0	1.5	1.4	1.4	1.2	0.9
Net exports (% of GDP)	-0.8	0.9	0.5	-0.9	-2.3	4.4	-1.0	0.3	-0.1	0.0	0.2	0.2	0.1
Final Domestic Demand (% of GDP)	-7.9	3.6	3.2	-5.5	-10.4	13.2	-1.3	0.0	0.8	1.0	1.1	0.8	0.6
CPI (y/y)	-0.1	0.7	1.0	0.3	-0.1	-0.5	-0.2	0.5	0.5	0.8	0.9	0.6	0.9
Unemployment (%)	9.2	10.3	10.8	9.2	8.4	9.8	9.3	9.8	10.2	10.5	10.6	10.7	10.8
Real Disposable Income (y/y)	-2.5	0.5	1.8										
Saving rate (%)	15.5	14.0	12.0										
Current Account (% GDP)	3.6	3.1	3.2										

Note: y/y growth rate calculated from seasonally and calendar adjusted series. Source: Intesa Sanpaolo – Research Department

Fiscal policy as accommodative as last year

Discretionary fiscal policy measures for 2021 are worth a similar amount to those introduced in 2020 (ex-ante face value in billion, cumulated effects)

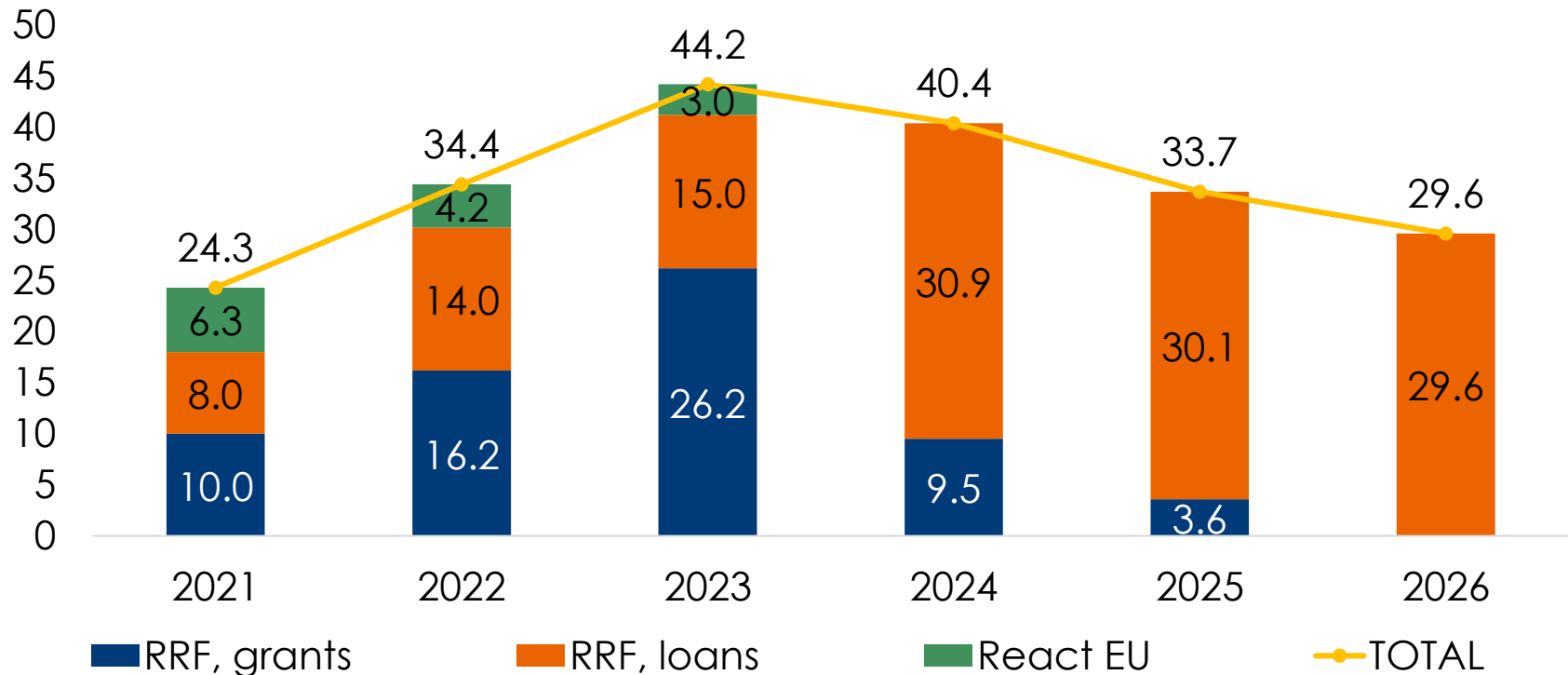


Source: Intesa Sanpaolo elaborations on Italian Government data

The Govt plans a full use of Next Gen EU...

The 2021 Budget includes a **Revolving Fund** to anticipate planned interventions, while awaiting for the actual allowance of EU funds (grants and loans). It is worth EUR 121 Bn in 2021-23, of which EUR 35 Bn in 2021 (higher than reported in NADEF).

The use of NEXT GEN EU resources planned by the Italian Government



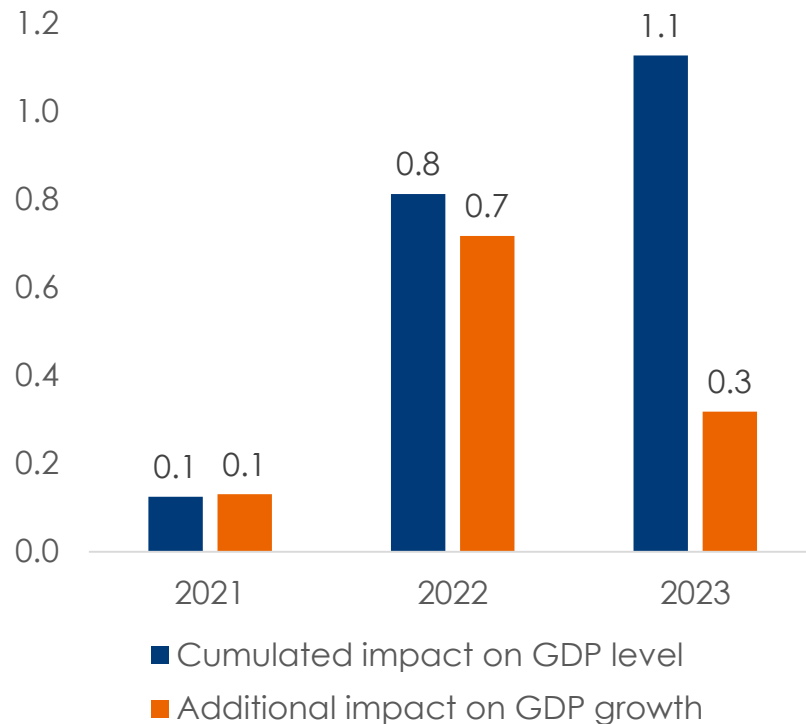
Note: TOTAL is the sum of resources from RRF and React EU (total: EUR 203 Bn); the Italian Govt also plans to receive funds from other programmes, bringing the total to EUR 205 Bn.

Source: NADEF 2020 (Update to Economic and Financial Document)

...whose impact could be highest in 2022

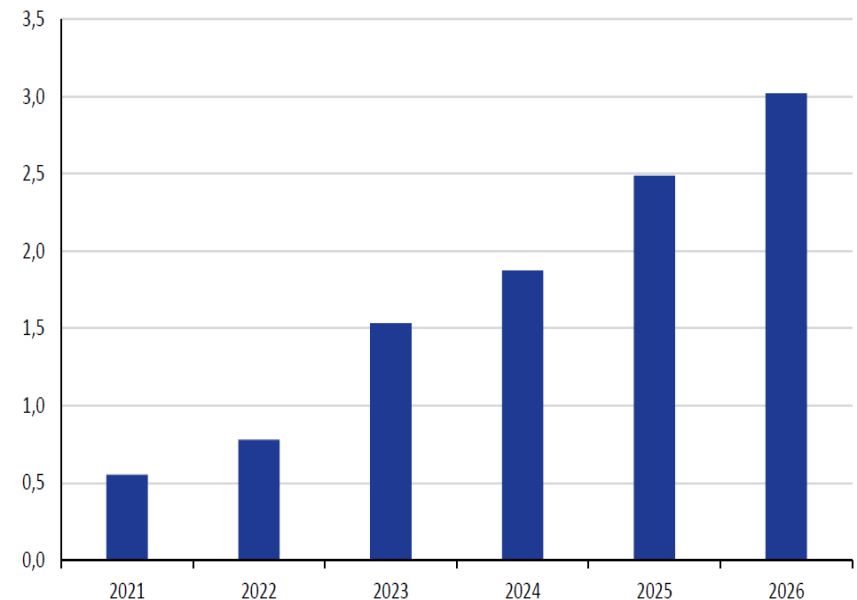
Out of a total EUR 204.5 Bn, EUR 191.5 Bn will come from the RRF (EUR 69 Bn grants, EUR 122.5 Bn loans). Just EUR 40 Bn loans should be *additional*.

ISP estimate (shock on public investments from EU grants + additional loans)



Source: Intesa Sanpaolo calculations

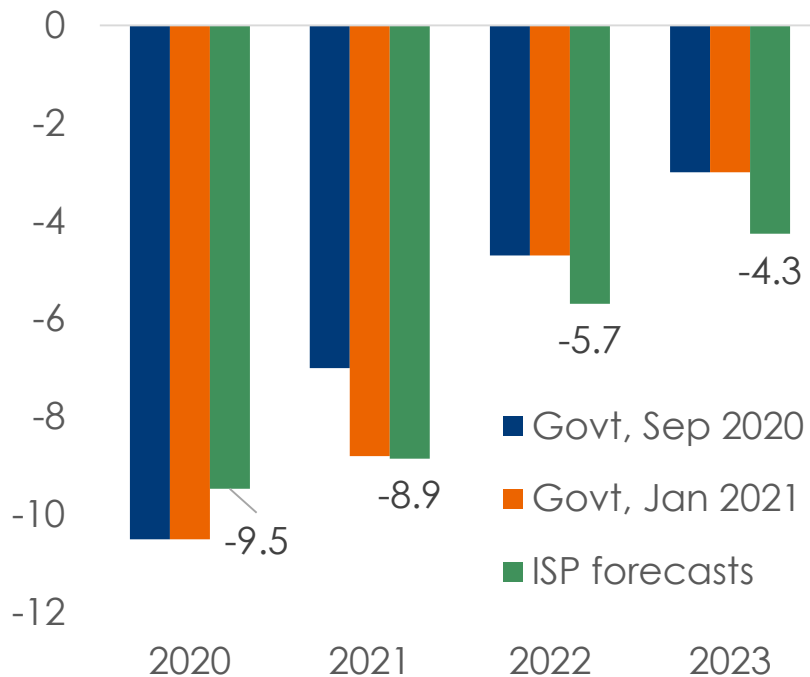
The Govt estimates an impact at regime of 3%, due to a multiplier effect on private investments



Source: Intesa Sanpaolo calculations

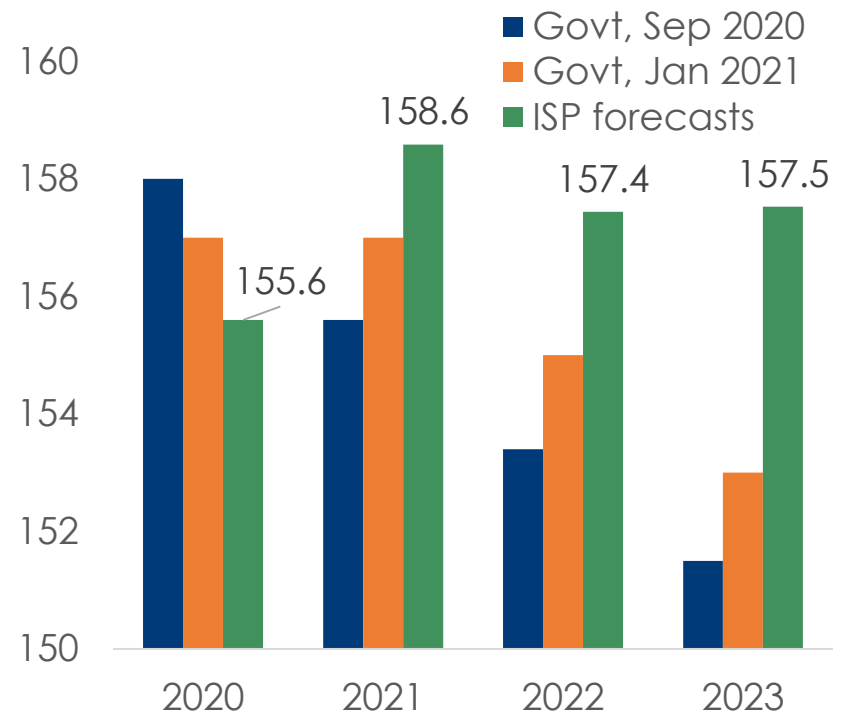
Risks on the debt trajectory

Deficit/GDP: Intesa Sanpaolo forecasts and Government targets



Source: Intesa Sanpaolo forecasts, Italian Government policy framework (Draft Budgetary Plan) and Report to Parliament of 20 January 2021

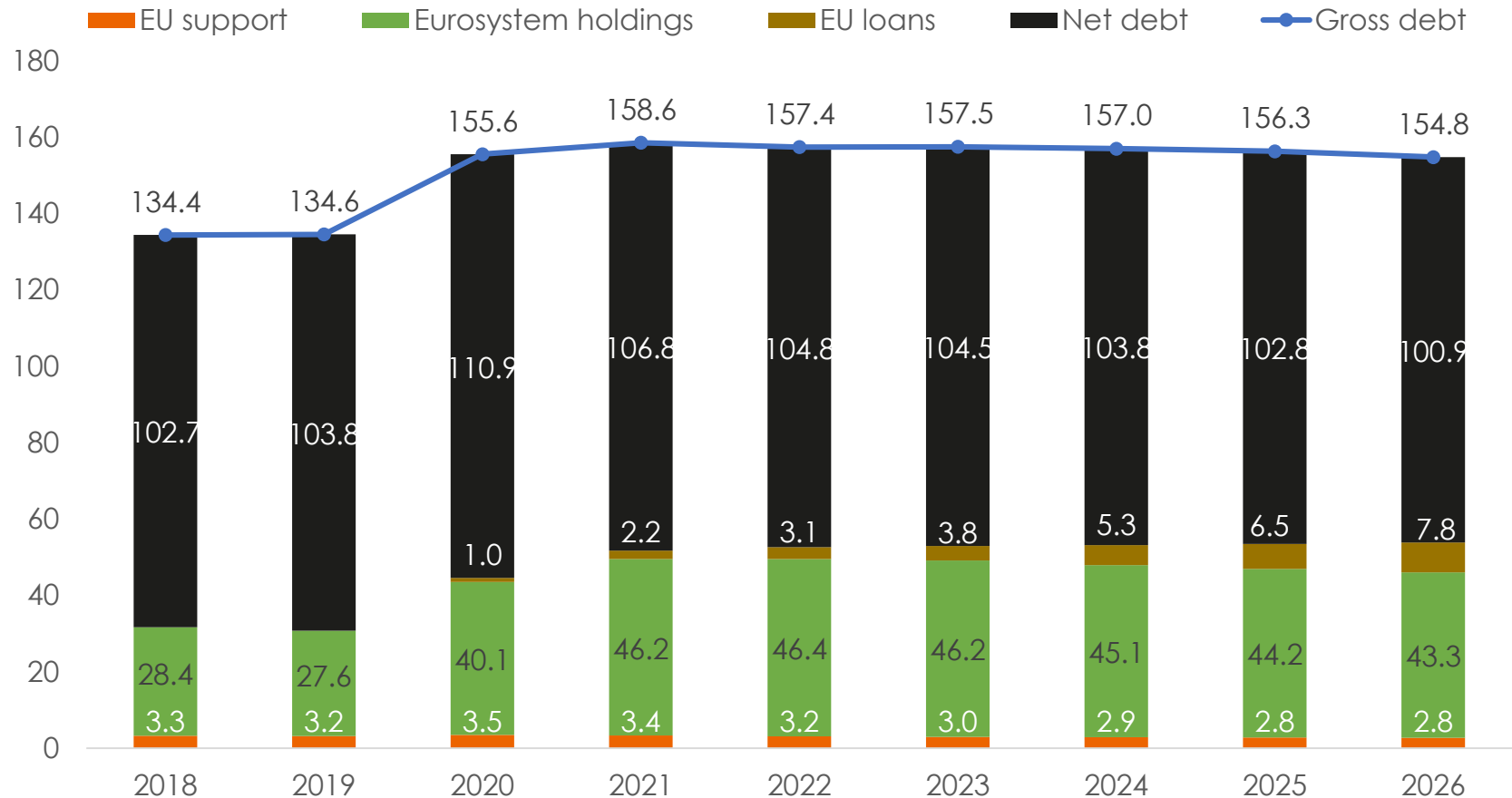
Debt/GDP: Intesa Sanpaolo forecasts and Government targets



Source: Intesa Sanpaolo forecasts, Italian Government policy framework (Draft Budgetary Plan) and Report to Parliament of 20 January 2021

Yet, debt is increasingly owned by institutional players

Government Debt as a % of GDP

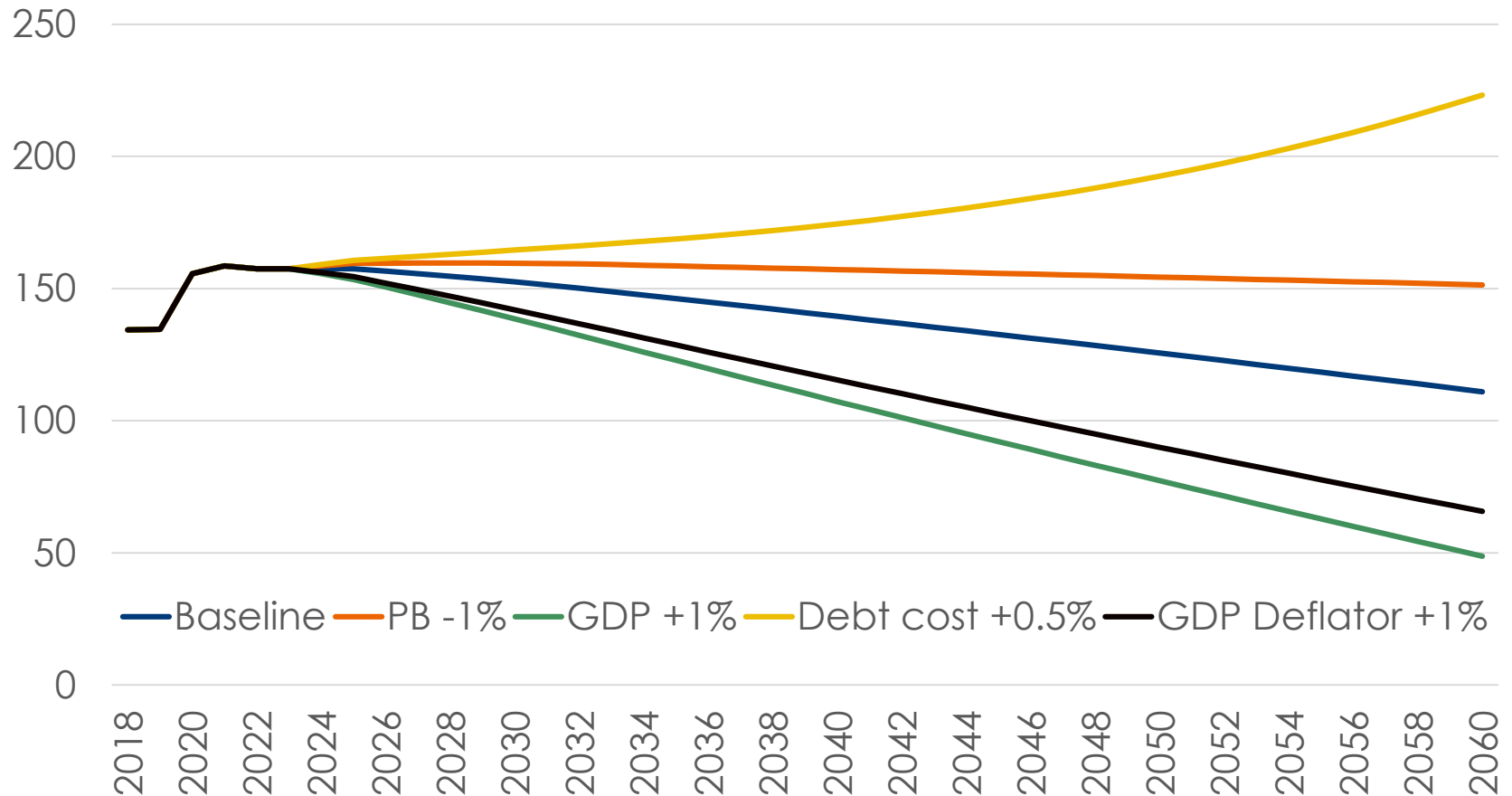


EU support = Italy's shares of the loans to Member States of the EMU, bilateral or through the EFSF + Italy's contribution to the capital of the ESM; EU loans = SURE + Next Gen EU loans.

Source: Intesa Sanpaolo calculations

Sustainability will depend crucially on GDP growth

Debt/GDP ratio under different scenarios on GDP, CPI, PB and interest rates



Note: Baseline assumptions: ISP forecasts of GDP and GDP deflator up to 2025. From 2026 onwards: GDP = 0.5%, GDP deflator = 1.5%; ISP forecasts interest expenditure up to 2023. From 2024 onwards: cost of debt on the rise by one tenth per year, from 2.1% in 2023, to 2.5% in 2027; ISP forecasts of the Primary Balance until 2023: primary balance improvement by 1% per year, from -1.1% in 2023 to +1.9% in 2026 (and to 2% starting in 2027).

Source: Intesa Sanpaolo calculations

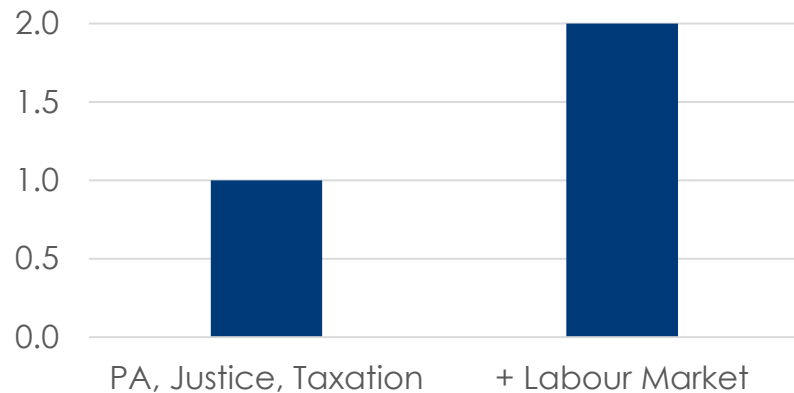
After a «lost triennium», reforms back on the agenda

- **Competition:** the Government will ask the Antitrust Authority to produce its proposals on the issue as soon as possible, as required by the Annual Law on Competition (largely disregarded in recent years);
- Comprehensive **tax reform** (entrusted to trained experts), with the aim of reducing the tax burden while preserving the progressiveness of taxes, and strengthening the fight against tax evasion;
- **Reform of the PA** through not only the elimination of the backlog accumulated during the pandemic, but by increasing digital investments (with the creation of efficient and easy-to-use platforms by citizens) and by focusing on the continuous updating of skills of public employees (also by selecting the best skills and attitudes in hiring quickly and efficiently);
- **Reform of justice** that takes into account the recommendations made by the EU Commission: favoring the full implementation of the reform of insolvency procedures, ensuring a more efficient functioning of the courts, facilitating the clearing of the backlog and better management of workloads, adopting simpler procedural rules, filling vacancies for administrative staff, reducing differences in the management of cases from court to court, encouraging fight to corruption.

The impact of reforms on GDP

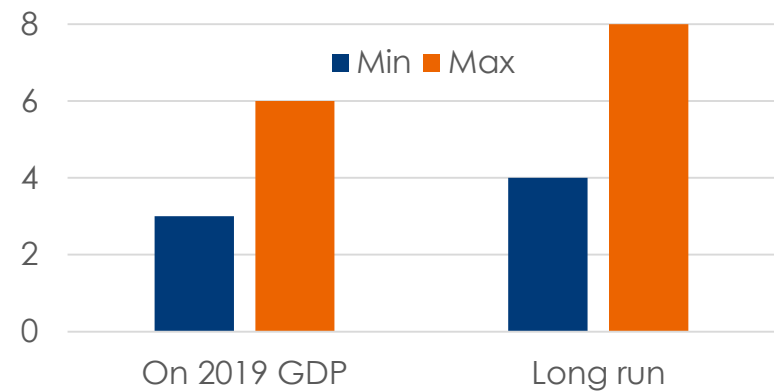
- The Government estimates that the 3 reforms included in the NRRP (**PA, Justice and Taxation**) can have an **impact on GDP in 5 years widely higher than 1%**. A **labor** reform leading to an increase in the participation rate would have a further impact of **at least 1%**.
- Bank of Italy (Ciapanna, Mocetti and Notarpietro, 2020) estimated recently the impact of **3 reforms adopted between 2011 and 2017**: service sector liberalizations, incentives to innovation and civil justice reforms. The increase in the level of GDP as of 2019 due to the sole effect of these reforms would be 3-6%. **The long-run increase in Italy's potential output would be 4-8%.**

Govt estimates about the impact of reform included in the NRPP (in 5 years)



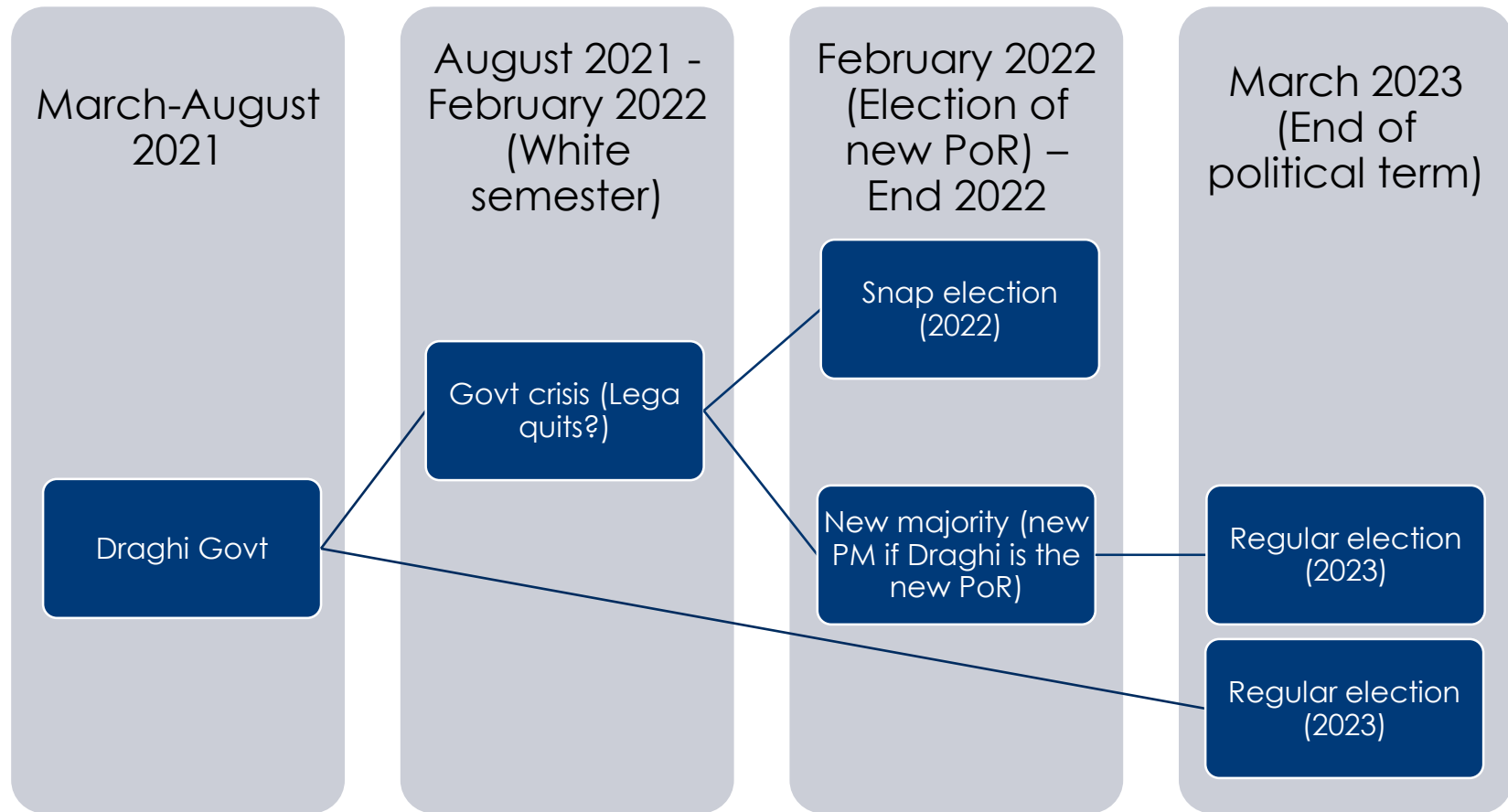
Note: impact on GDP level after 5 years.
Source: Italian Government

Bank of Italy estimates about the impact of reforms approved in 2011-2017



Note: impact on GDP level. Source: Bank of Italy

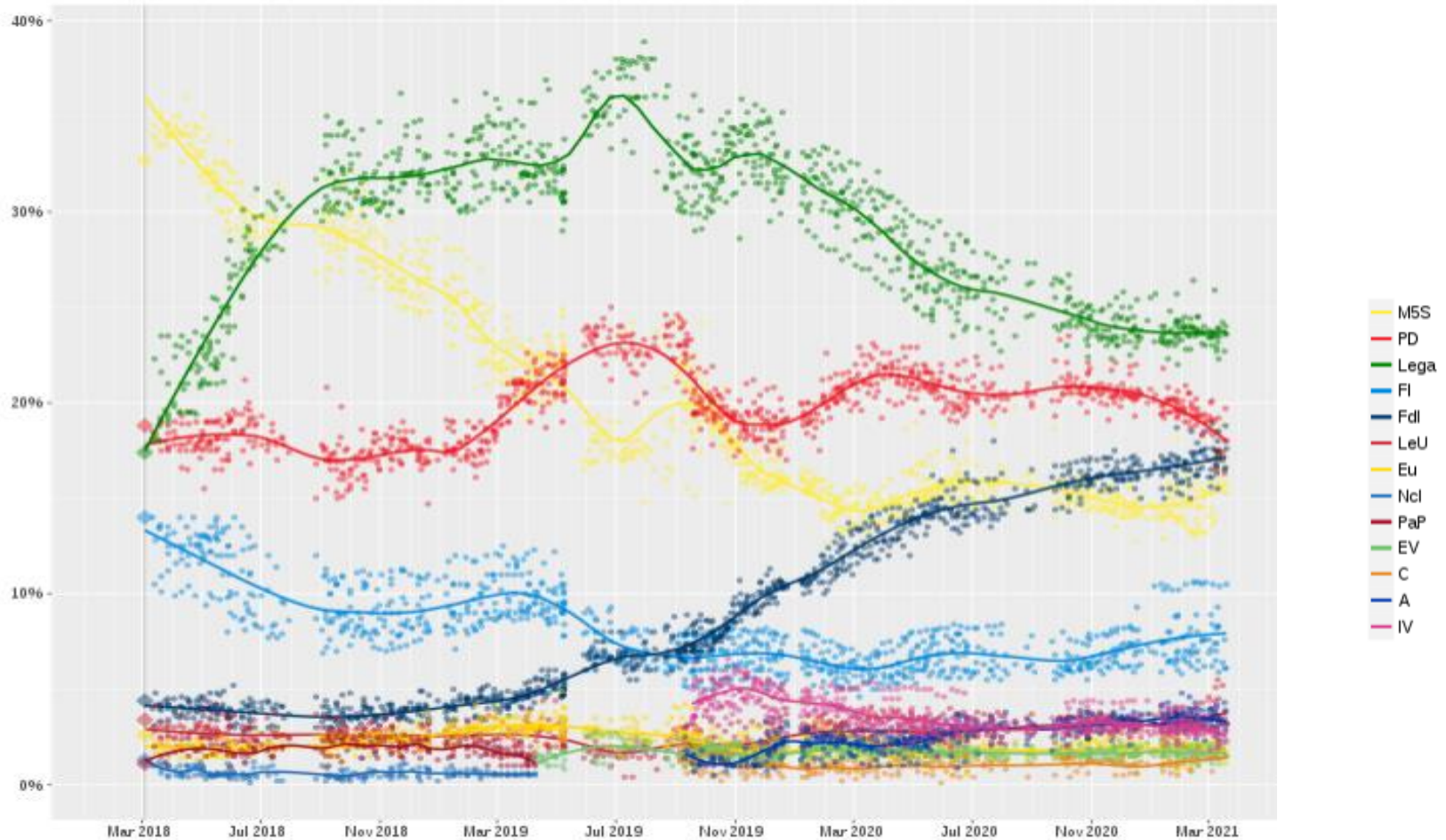
Election of the new PoR: a crossroads for Draghi?



Scenarios	Probability	Investors' preference
Govt crisis -> Snap election in 2022	45%	4
Govt crisis -> New majority, new PM	55%	3
Govt crisis -> New majority, same PM		2
Same majority up to 2023		1

After Draghi's truce, parties could return to war

Italy – Opinion polling on the next political election (% of total)

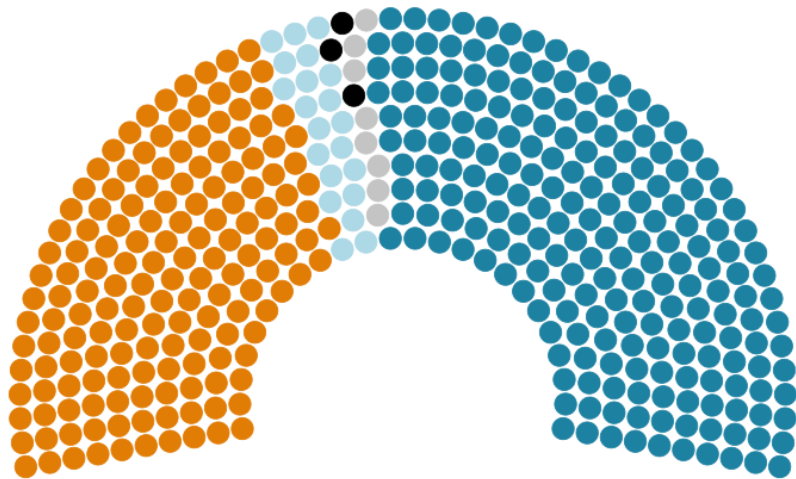


Source: Euromedia, EMG, SWG, Ixè, Piepoli, Tecnè, IPR, Ipsos, Demopolis, Datamedia

What will the next Parliament look like?

- Assumption: current electoral system, pre-election alliances: CSX+M5S (PD, Left, 5SM) vs CDX (Lega, Fratelli d'Italia, Forza Italia) vs Center (Italia Viva, Azione, +Europa).

Seats in the Chamber of Deputies



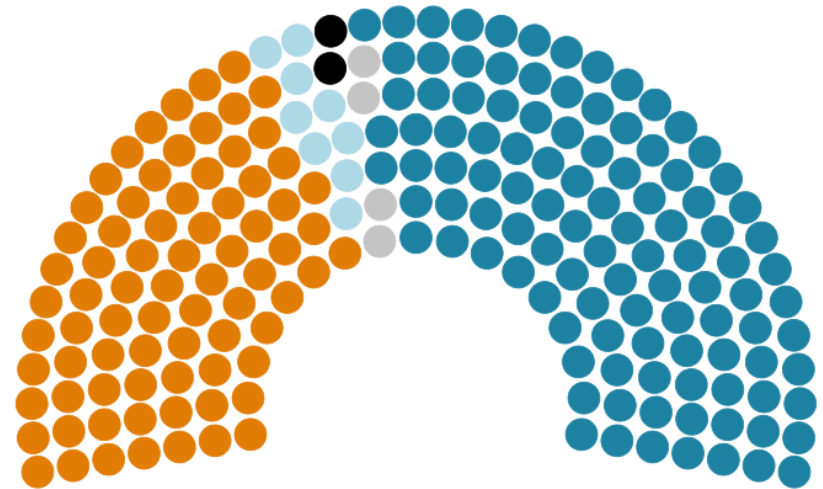
Coalizione

- CSX+M5S
- Centro
- SVP
- Estero
- CDX

Deputati

158
21
3
8
210

Seats in the Senate



Coalizione

- CSX+M5S
- Centro
- SVP
- Estero
- CDX

Senatori

77
9
2
4
108

Source: YouTrend poll, January 2021

Source: YouTrend poll, January 2021

The perfect inflation storm of 2021

The euro area limps along the recovery path

Italy: risks in the s/t, opportunities in the medium run



The U.S.: undisputed leader in the pandemic race

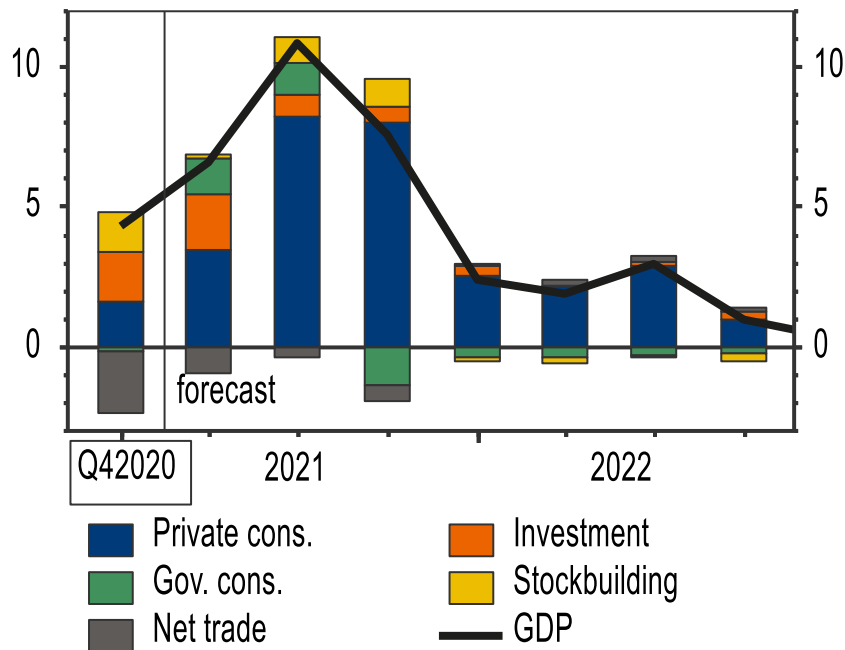
Interest rate outlook

US: undisputed leader in the post-pandemic race

- The US stands out in the post-pandemic world on 3 crucial fronts:
 - **Pandemic control**: far ahead with respect to most advanced countries
 - **Fiscal stimulus**: larger and faster
 - **Monetary policy strategy**: more committed to patience on inflation and employment
- To some extent, authorities are on a **new policy experiment**: run economy super-hot, react only after achieving targets/see excesses.
- Risks mostly for medium/long term. But definitely a **regime change**. Uncertainty over impact on growth/deficit/inflation, depending on details and implementation.
- Question is: will it be a return to the pre-70's or to the post-70's?
- Growth is already on a booming trajectory, net risks to the upside on both growth and inflation. Still some downside risks on the pandemic front.
- **BOTTOM LINE: GROWTH CLOSE TO 7% IN 2021 AND 3.5% IN 2022, OUTPUT GAP CLOSED IN 2021, INFLATION AROUND 2.5% THROUGH MID-2022.**

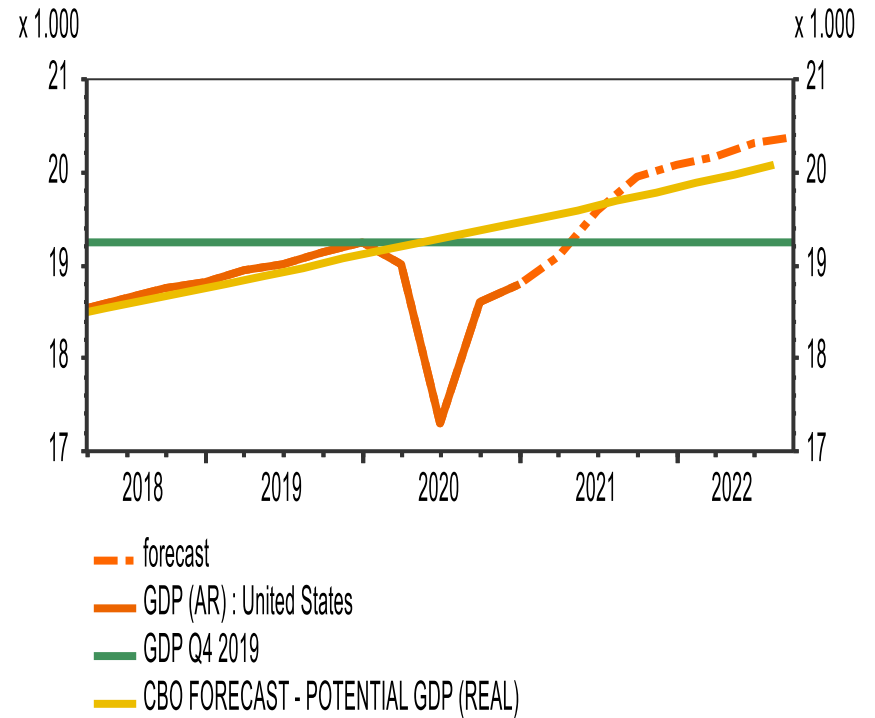
Growth turbo-charged by vaccines, fiscal stimulus, Fed's patience: risks to the upside

Growth skyrocketing in 2021...



Source: Refinitiv-Datastream. IntesaSanpaolo forecasts

...will close the output gap by year-end

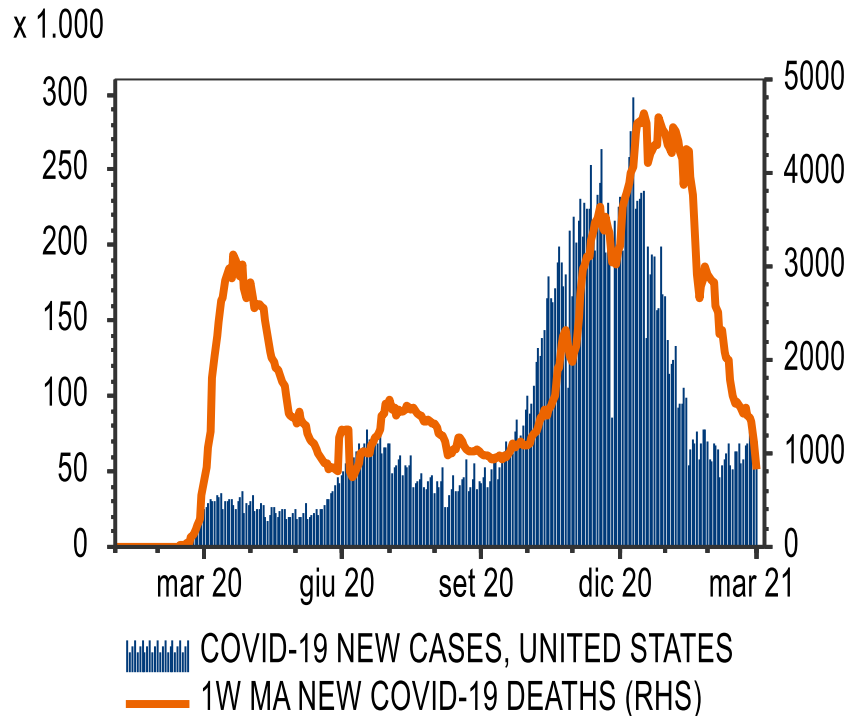


Source: Refinitiv-Datastream. Output gap: CBO forecasts, GDP after 2020: intesa Sanpaolo forecasts

Herd immunity is in sight

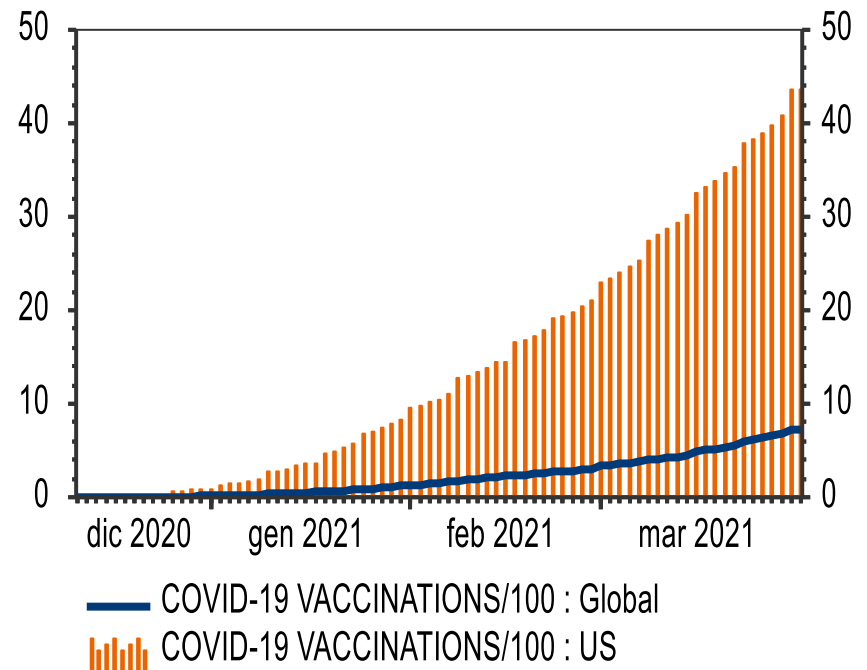
As of 30/3, doses administered=147,602 mln, 45% of population and 57,8% of 18+ population. At current pace of daily immunizations (7-day avg=2.77 mln), 90% of the population will have received at least one shot by 26 July.

New cases and deaths



Source: Refinitiv-Datastream

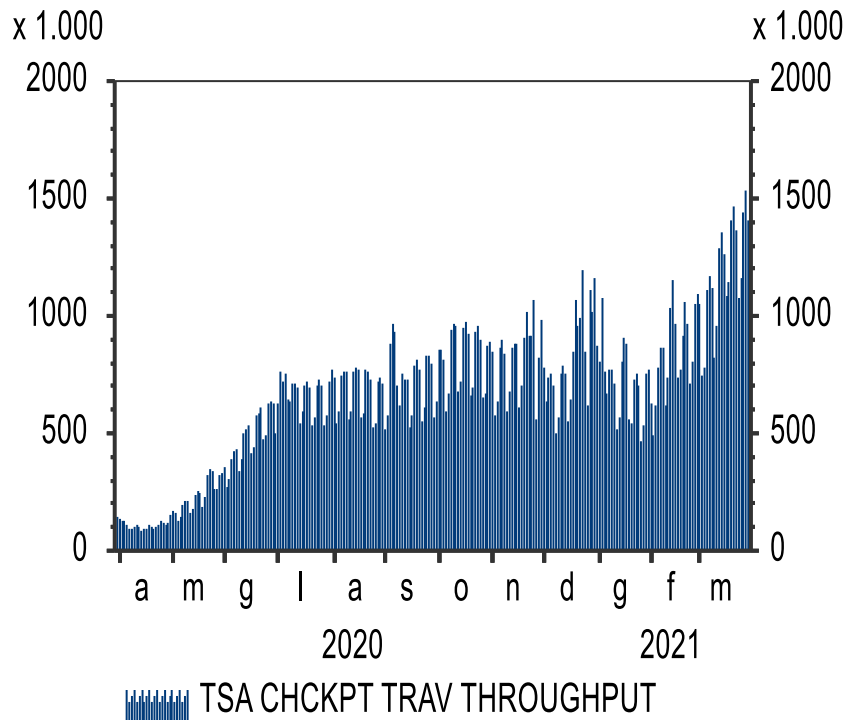
The vaccine rollout keeps speeding up



Source: Refinitiv-Datastream

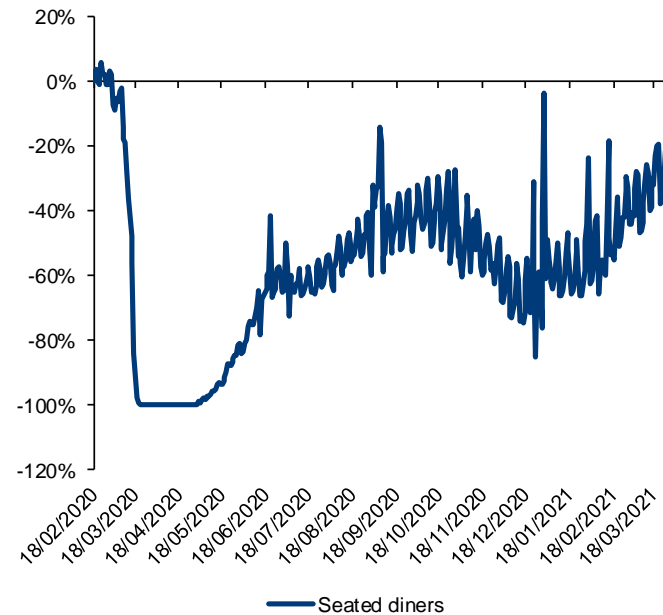
Activity in the service sector already on a new path, a pre-condition for the growth boom

People are flying again...



Source: Dallas Fed

...and going back to restaurants



Source: Opentable

Rapid-fire fiscal stimulus, for 28% of GDP, deficit-financed

Legislative actions since March 2020: 6 tln

American Rescue Plan Act: 1.9 tln

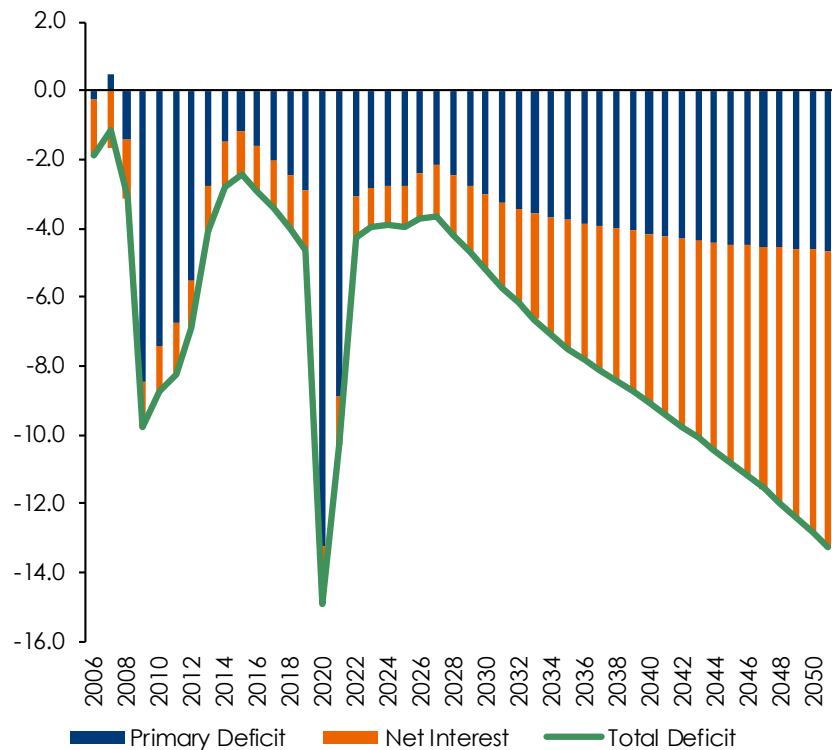
Total legislative actions	allowed	disbursed	deficit impact	ARP legislative actions	allowed	disbursed	deficit impact
Loan and grant programs			1.03	State & local funding	0.515	0	0.513
Income support	1.54	1.05	0.882	Direct payments	0.412	0.242	0.412
State & local funding	0.912	0.578	0.873	Other spending	0.26	0	0.234
Direct payments	0.875	0.309	0.87	Income support	0.249	0	0.249
Health spending	0.87	0.658	0.667	Health spending	0.196	0.012	0.196
Tax policy	0.686	0.311	0.426	Tax policy	0.185	0	0.185
Other spending	0.573	0.333	0.46	Loan & grant programs	0.0681	0	0.0624
Total	6.0	3.4	5.2	Total	1.89	0.25	1.85

Source: CRFB. Data in tln dollars. Memo: 2020 nominal GDP: 20.93 tln dollars

Source: CRFB. Data in tln dollars

The Recovery Plan is on its way: its financing will matter for the outlook

Primary deficits and interest costs under current legislation



Source: Congressional Budget Office. Projections under current legislation. Projected debt/GDP at 201% in 2051

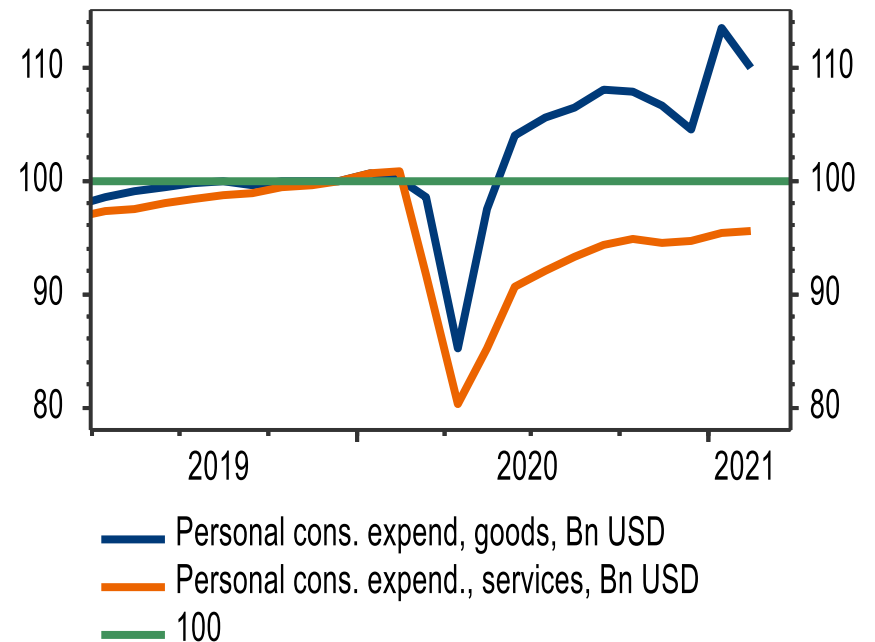
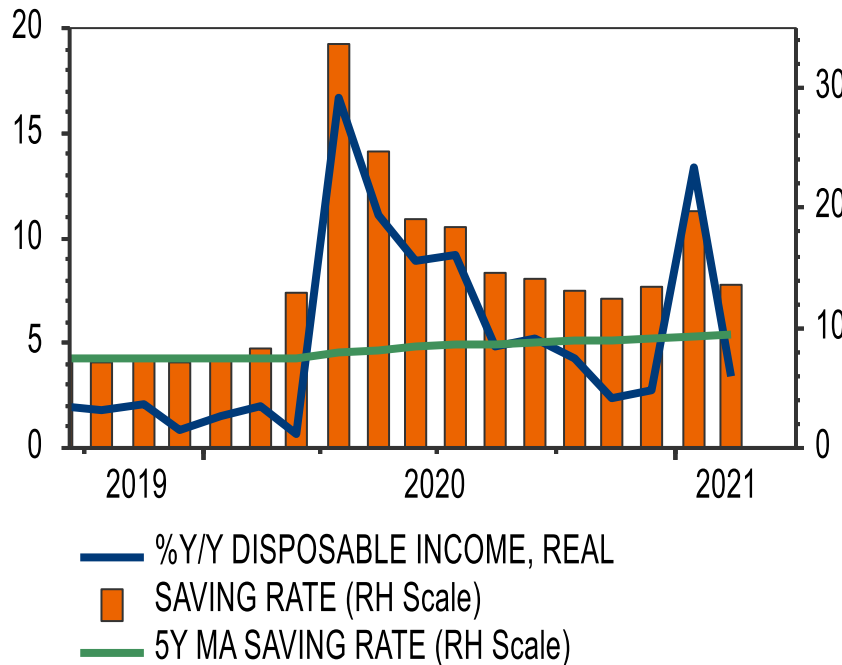
- **The Build Back Better Recovery Plan is starting to take shape**, with structural measures for infrastructure, environment, education and reduction of inequalities.
- Spending for approximately 3 tln dollars (14% of GDP)+possible extension of tax credits worth 1.6 tln.
- **Plan likely split in 2 parts:** infrastructure (app. 2 tln) and welfare (between 1 and 2 tln). Financing should be a mix of deficits and tax hikes on corporations and high income households.
- Impact on growth/ deficit/inflation uncertain and depending on details.

Consumption ready to take off, again

In 2020, disposable personal income 0,6 tln above trend, consumption 1 tln below trend=> **1,6 tln excess savings ready for 2021 spending**

Disposable income and savings will finance a new wave of consumption...

...with a rebalancing towards services

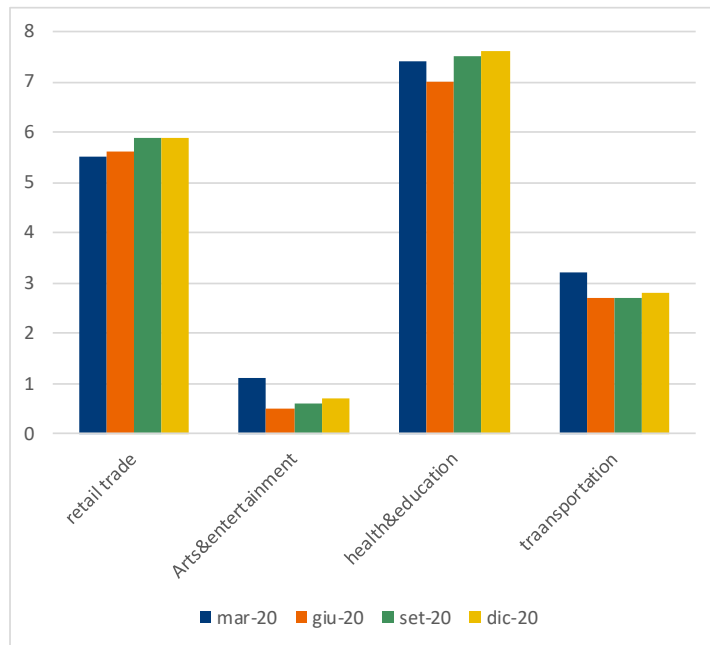


Source: Refinitiv-Datastream

Source: Refinitiv-Datastream. Data rebased at 100 on Feb. 2020.

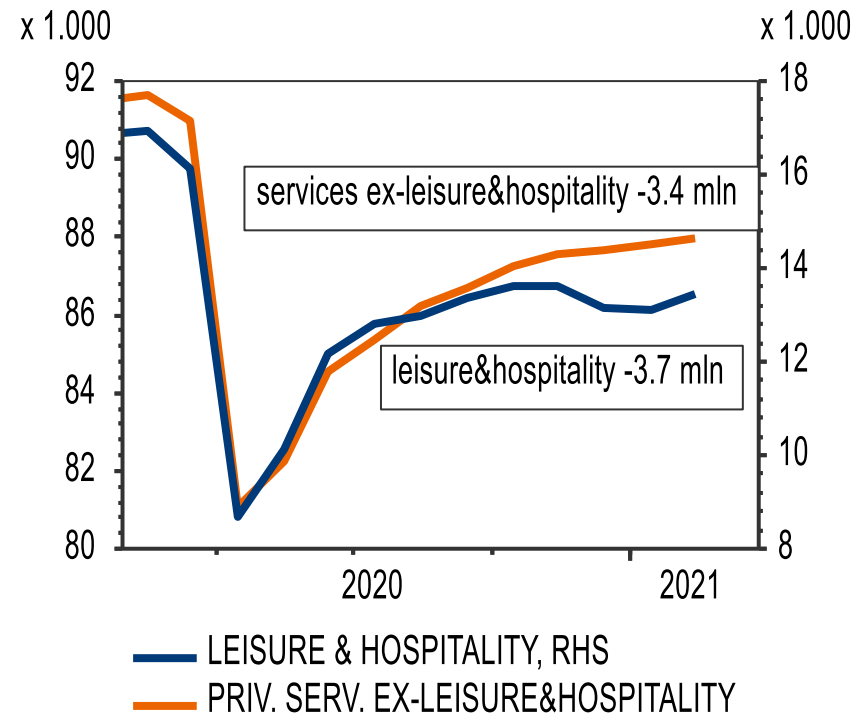
Once the economy re-opens, output and employment in the service sector will skyrocket

Value added by industry:
normalization still incomplete for
some sectors



Source: FRED

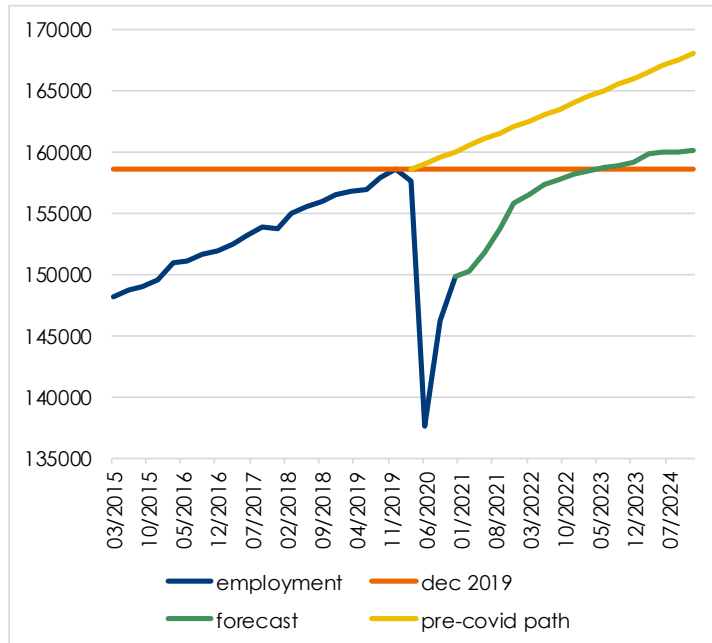
Around 7.1 mln jobs missing in the private
service sector



Source: Refinitiv-Datastream

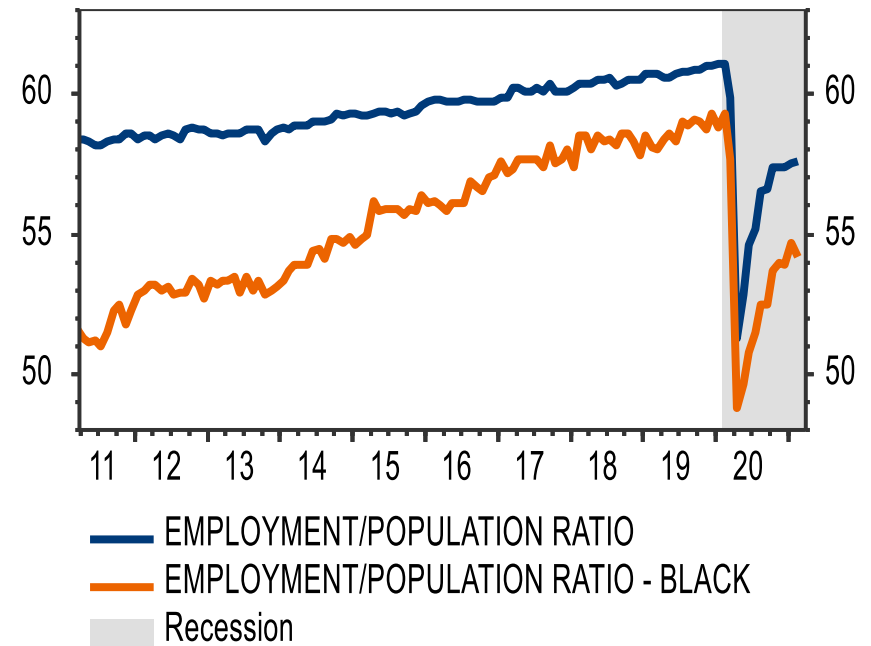
Still a long way from «maximum inclusive employment»

A 9.5 mln jobs gap...



Source: BLS, Intesa Sanpaolo calculations and forecasts

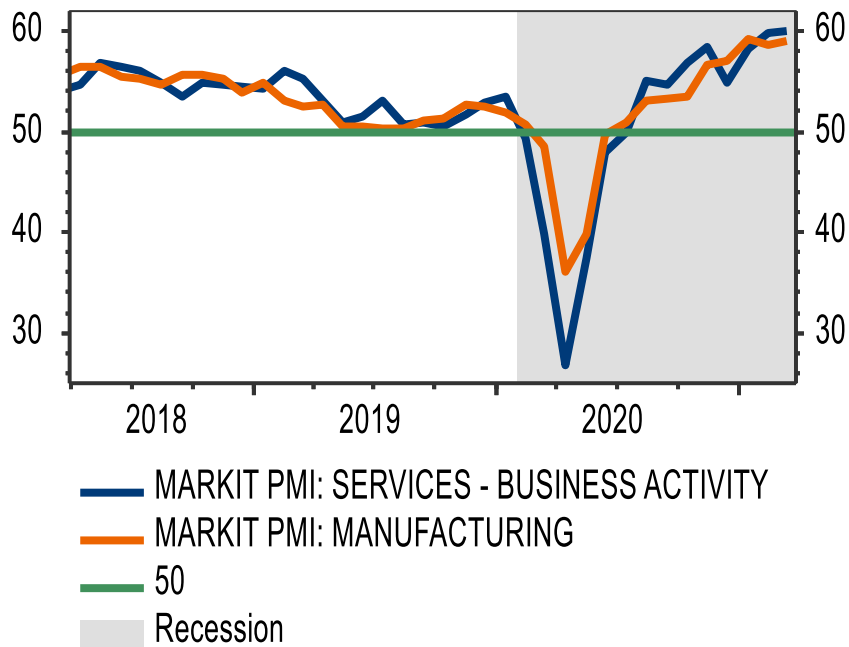
...and a huge loss of «inclusive employment»



Source: Refinitiv-Datastream

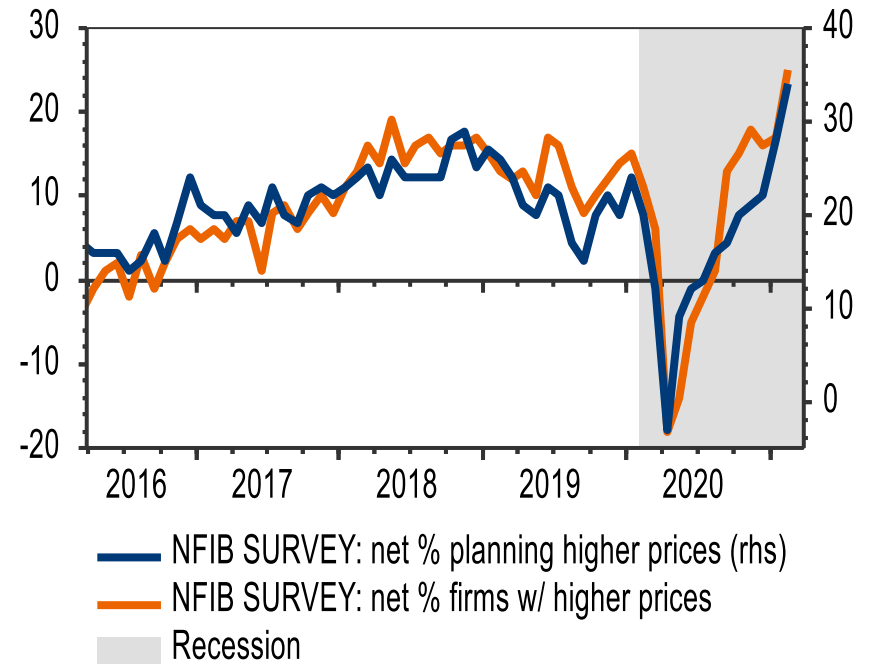
How much excess demand?

The economy will run on all cylinders as soon as all sectors reopen



Source: Refinitiv-Datastream

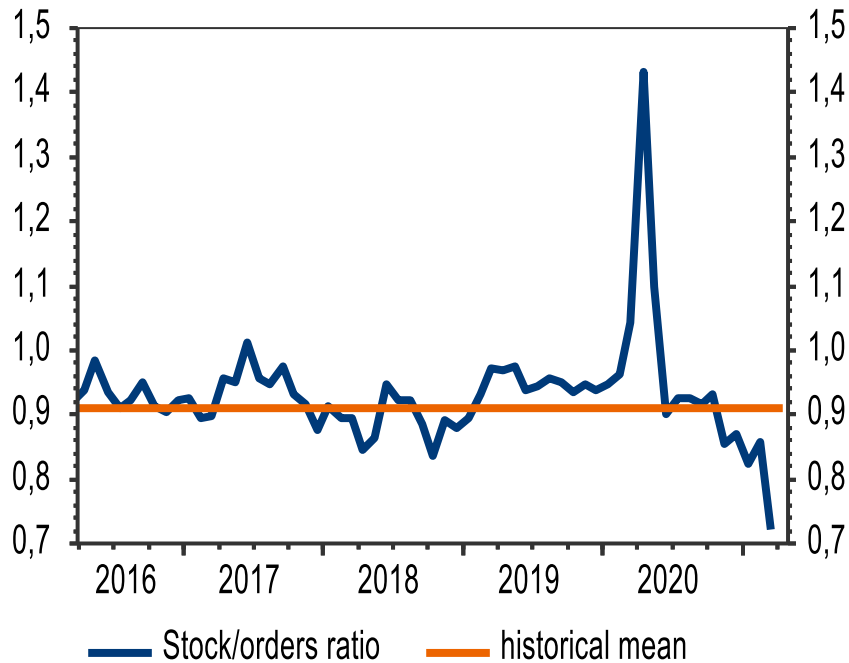
Firms will use some of their new pricing power



Source: Refinitiv-Datastream

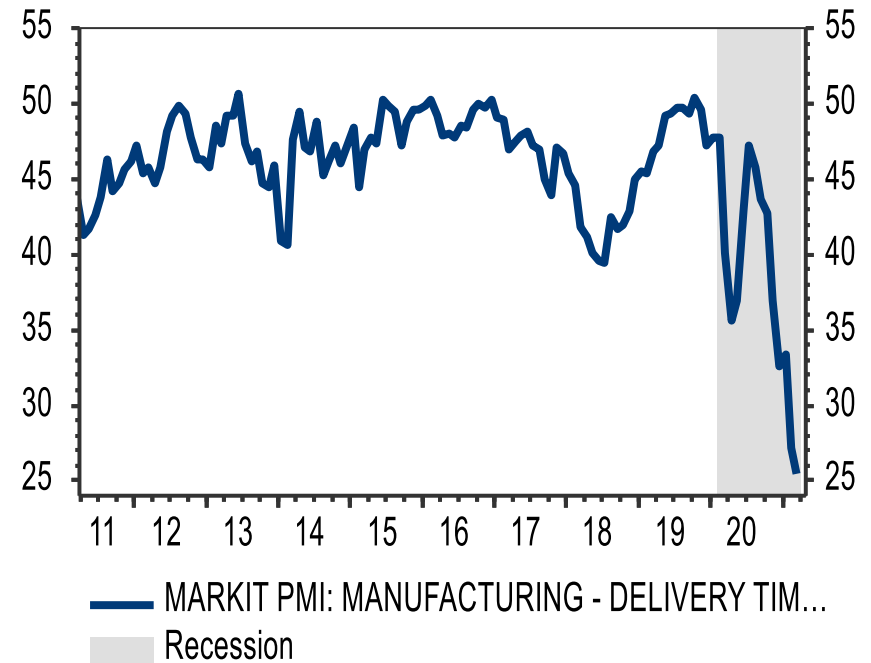
Supply side problems in the manufacturing sector

Inventories are way below desired levels...



Source: Refinitiv-Datastream

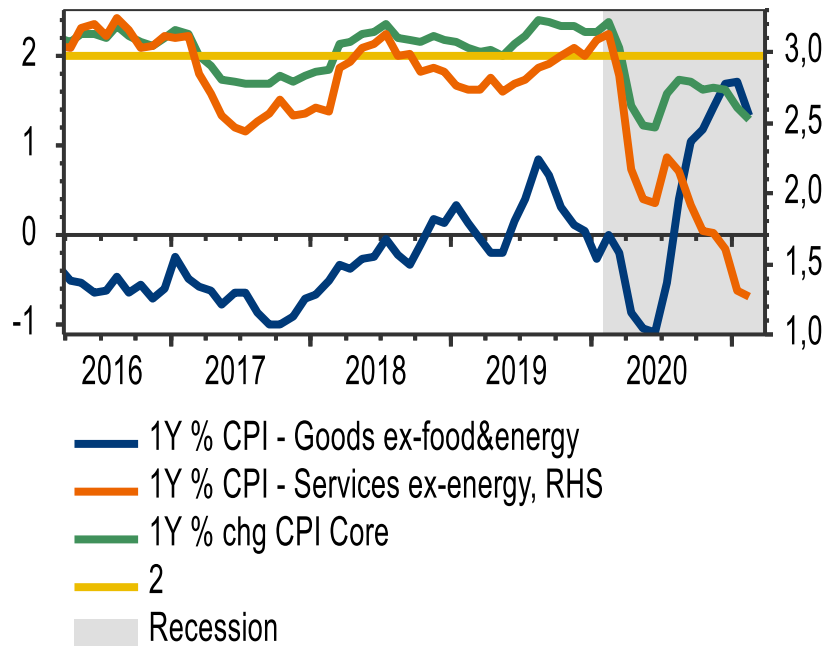
...and delivery times hit a new record



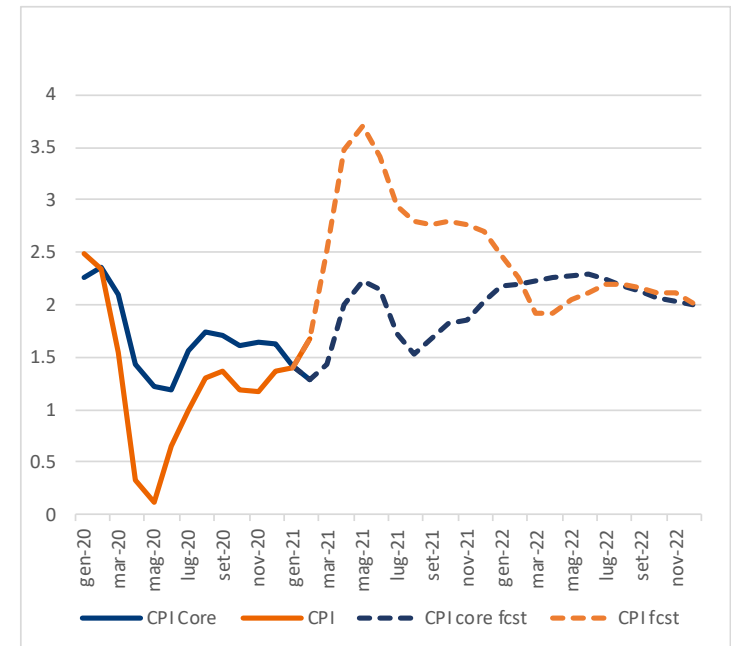
Source: Refinitiv-Datastream

Inflation to pick up in 2021-22, for statistical and economic reasons

A triple shot of upside pressures in 2021: comparison with 2020, repricing in the service sector and growing pricing power...



...but the stronger trend should subside after 2022



Fonte: Refinitiv-Datastream

Fonte: BLS, Intesa Sanpaolo forecasts

FOMC: the pre-emptive era is over

- The Fed has a new strategy and will move when there is «actual progress, not forecast progress».

- Conditions for **rate liftoff**:

- Maximum inclusive employment
- Average inflation at 2% and on track to moderately exceed 2% for some time

- **Our forecast: Q4 2023.**

- Conditions for **tapering**:

- «Substantial further progress» towards the Fed's goals.
- **Our forecast: discuss tapering in the fall, start tapering in 2022.**

Macroeconomic projections –Federal Reserve Board and Federal Reserve Bank Presidents – March 2021

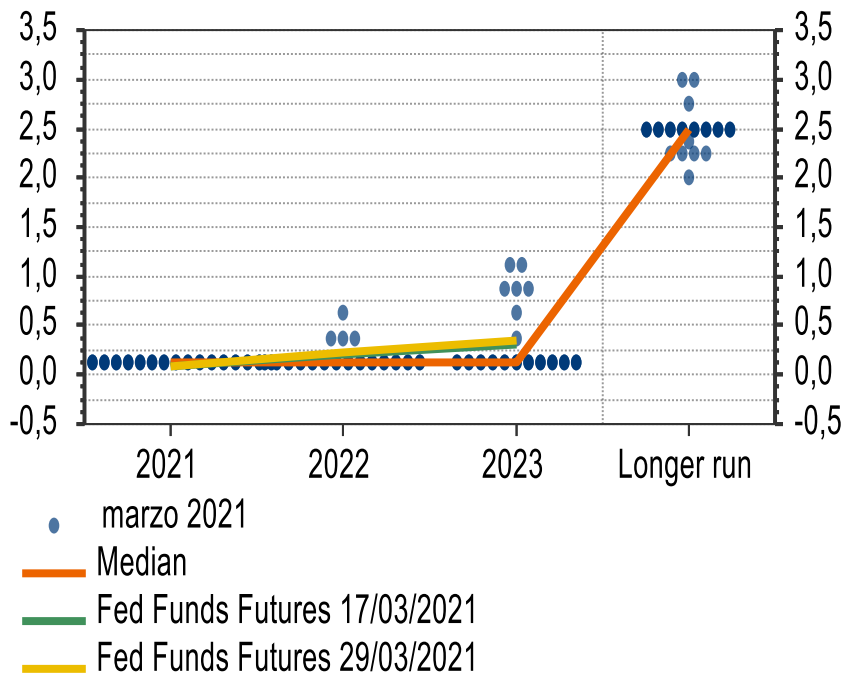
Variable	2021	2022	2023	Longer run
Real GDP	6.5	3.3	2.2	1.8
Dec projection	4.2	3.2	2.4	1.8
Unemployment rate	4.5	3.9	3.5	4.0
Dec projection	5.0	4.2	3.7	4.1
PCE inflation	2.4	2.0	2.1	2.0
Dec projection	1.8	1.9	2.0	2.0
Core PCE inflation	2.2	2.0	2.1	
Dec projection	1.8	1.9	2.0	
Memo: Projected appropriate policy path				
Federal funds rate	0.1	0.1	0.1	2.5
Dec projection	0.1	0.1	0.1	2.5

Source: Federal Reserve Board. For GDP and inflation, % changes Q4/Q4.

A new tug-of-war between the Fed and the markets

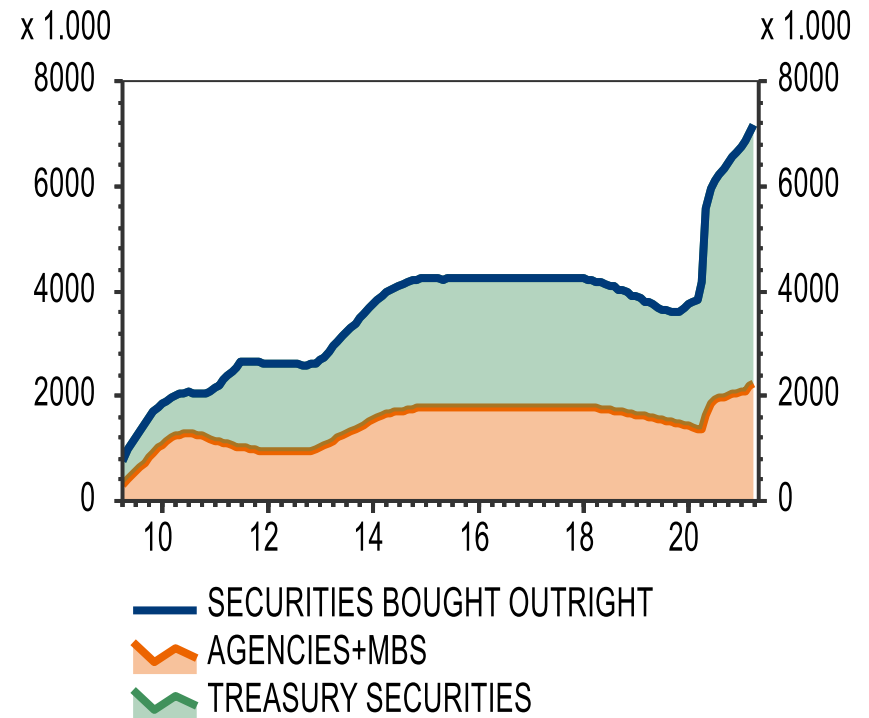
"The economy is a long way from our employment and inflation goals, and it is likely to take some time for substantial further progress to be achieved."
(J. Powell, 17.03.2021)

The Fed is trying to anchor expectations of policy rates



Source: Federal Reserve Board, Refinitiv-Datastream

«Now is not the time to talk about exit»



Source: Federal Reserve Board, Refinitiv-Datastream

United States – baseline forecast

Forecasts Table

	2020	2021e	2022e	2020			
				Q1	Q2	Q3	Q4
GDP (constant prices,y/y)	-3.5	6.8	3.2	0.3	-9.0	-2.8	-2.4
q/q annual rate				-5.0	-31.4	33.4	4.3
Private consumption	-3.9	7.5	4.7	-6.9	-33.2	41.0	2.3
Fixed investment - nonresid.	-4.0	8.1	1.7	-6.7	-27.2	22.9	13.1
Fixed investment - residential	6.1	12.1	0.6	19.0	-35.6	63.0	36.6
Government consumption	1.1	1.2	-2.0	1.3	2.5	-4.8	-0.8
Export	-12.9	6.6	6.4	-9.5	-64.4	59.6	22.3
Import	-9.3	13.1	4.1	-15.0	-54.1	93.1	29.8
Stockbuilding (% of GDP)	-0.7	1.1	0.0	-1.7	-4.3	6.5	1.4
Current account (% of GDP)	-3.1	-3.5	-3.0				
Gen. Gov. Deficit (% of GDP)	-16.1	-12.5	-6.1				
Gen. Gov. Debt (% of GDP)	161.7	159.9	157.9				
CPI (y/y)	1.2	2.7	2.0	2.1	0.4	1.2	1.2
Industrial production	-6.7	5.1	2.1	-1.7	-13.0	9.4	2.2
Unemployment (%)	8.1	5.4	4.4	3.8	13.1	8.8	6.8

Note: Percentage annualised growth rates over previous period, if not otherwise specified. Source: Refinitiv-Datastream

The perfect inflation storm of 2021

The euro area limps along the recovery path

Italy: risks in the s/t, opportunities in the medium run

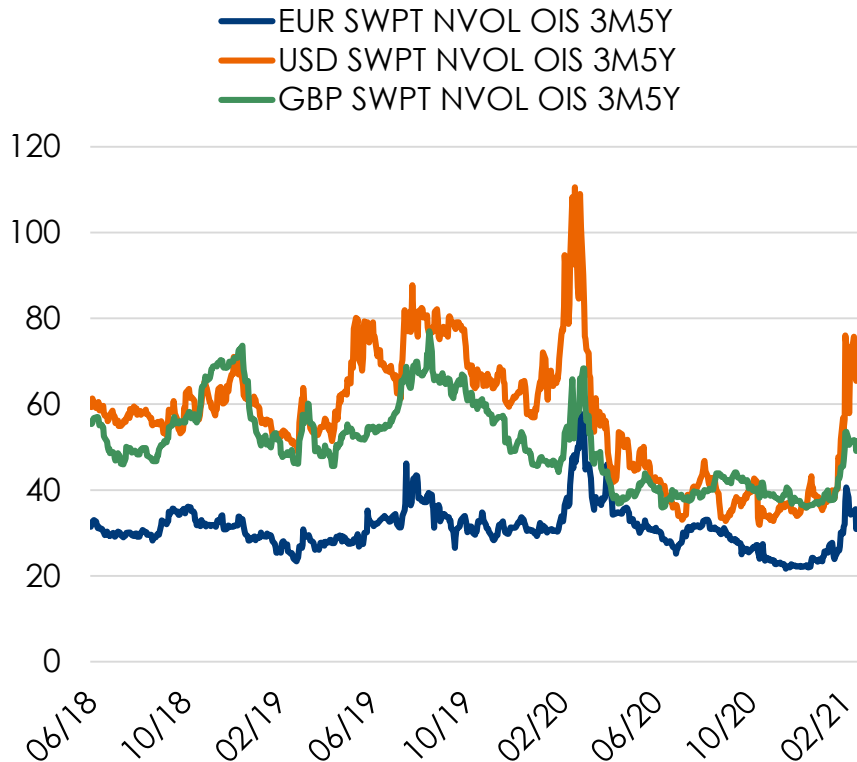
The U.S.: undisputed leader in the pandemic race



Interest rate outlook

Recent rates high volatility has been driven by the broad adjustment of macroeconomic factors ⁵⁸

Swaption ATM Norm Volatility (OIS)



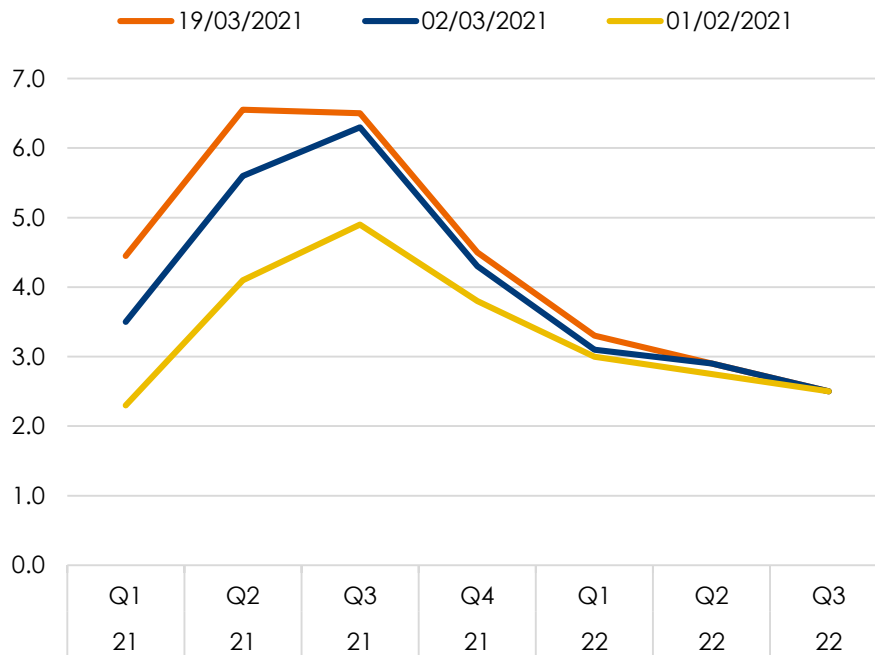
3M5Y/3M2Y USD Swaption ATM Norm Volatility (OIS)



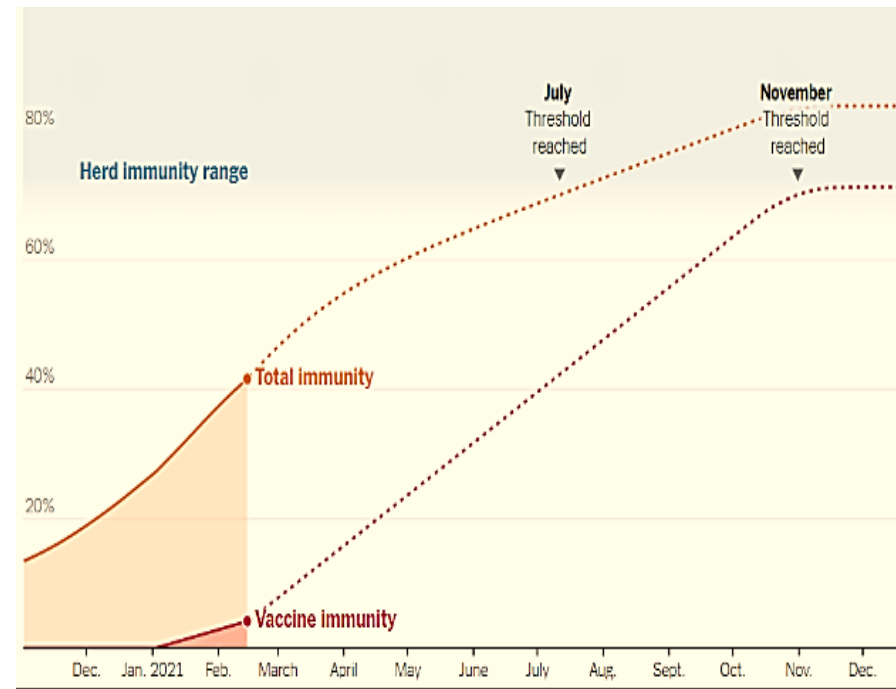
Source: Bloomberg, Intesa Sanpaolo

Two main factors behind the sell-off in UST: large upward revision of expected growth and the prospect to reach herd immunity

United States
QoQ ann. GDP growth forecast
 (Bloomberg Consensus, QoQ SAAR)



United States: scenarios to reach herd immunity (% of immune population)

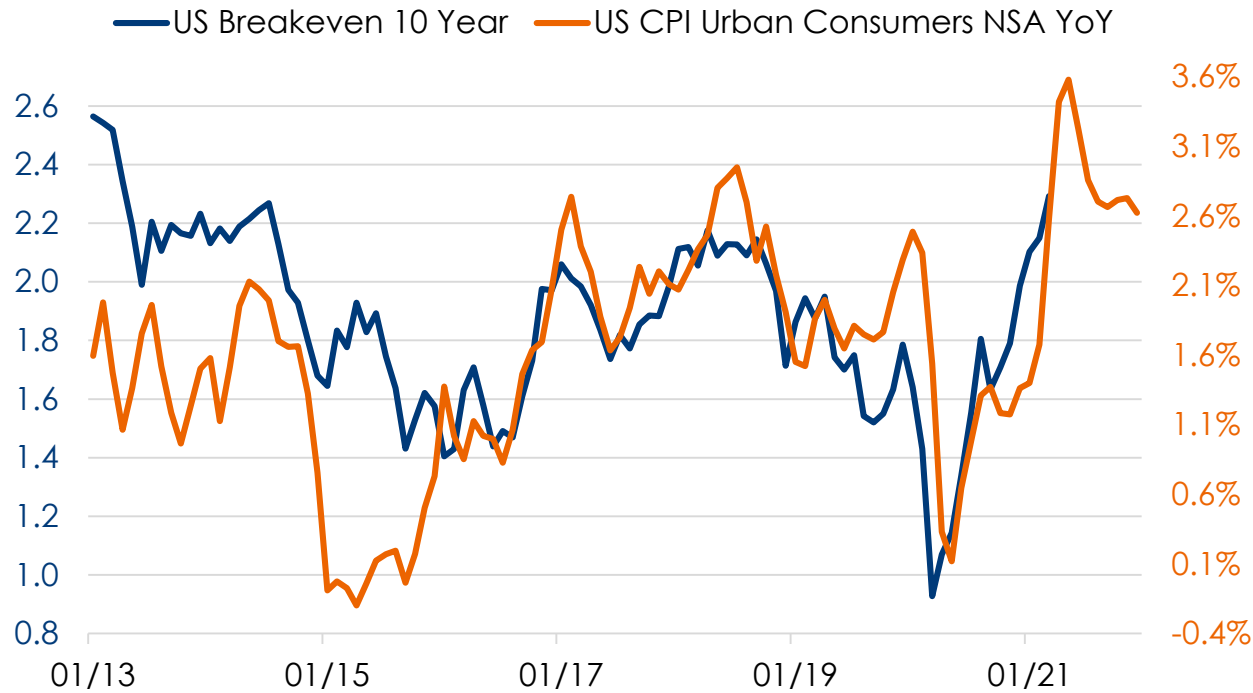


Total Immunity: Share of people who have been vaccinated plus the estimated share of people who have recovered from infection.
Vaccine Immunity: Share of people who are fully vaccinated.
Herd immunity range: 70 percent – 90 percent of people are immune to the virus either because of vaccinations or infection and recovery.
 Fonte: What's Going On in This Graph? | Covid Herd Immunity

Source: Bloomberg, Intesa Sanpaolo

The spike in inflation in May will fuel market fears of out-of-control inflation

United States
10Y TIPS BEI & inflation
 (Bloomberg Consensus, QoQ SAAR)



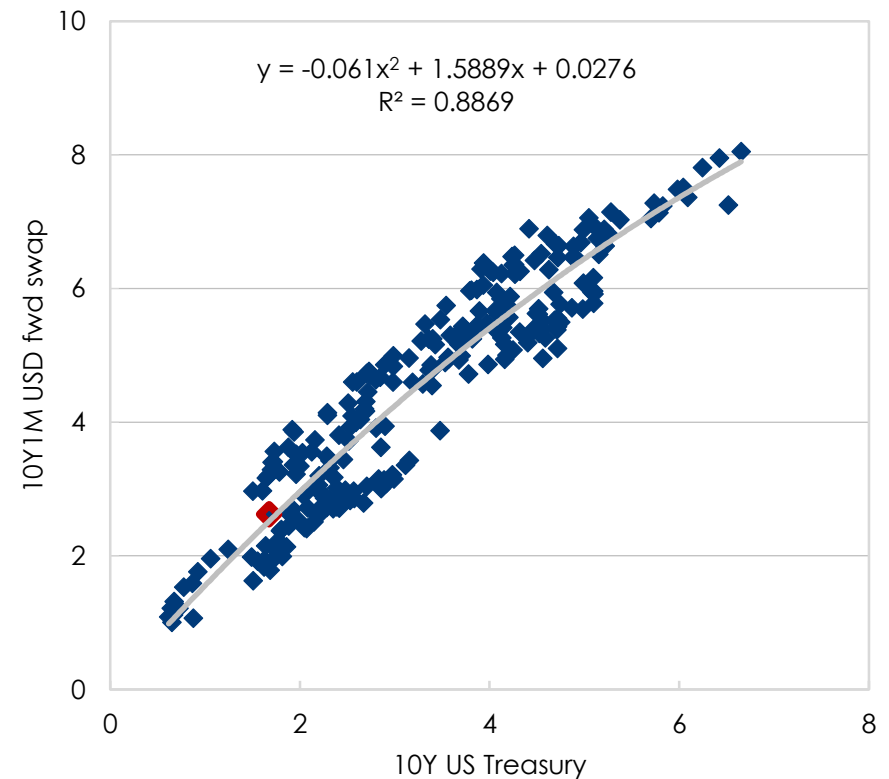
Source: Bloomberg, Intesa Sanpaolo

The market will test the peak at 3.0%-3.2% of the past hiking cycle in terms of long-term policy expectations

10Y1M USD swap (%)



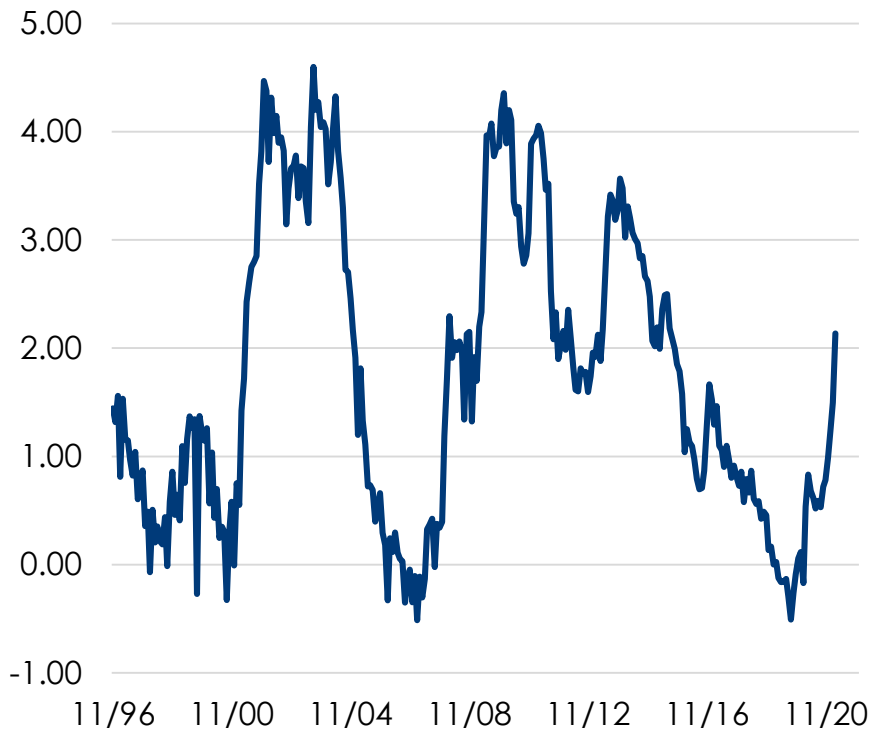
10Y1M USD fwd swap and 10Y US Treasury yield (%)



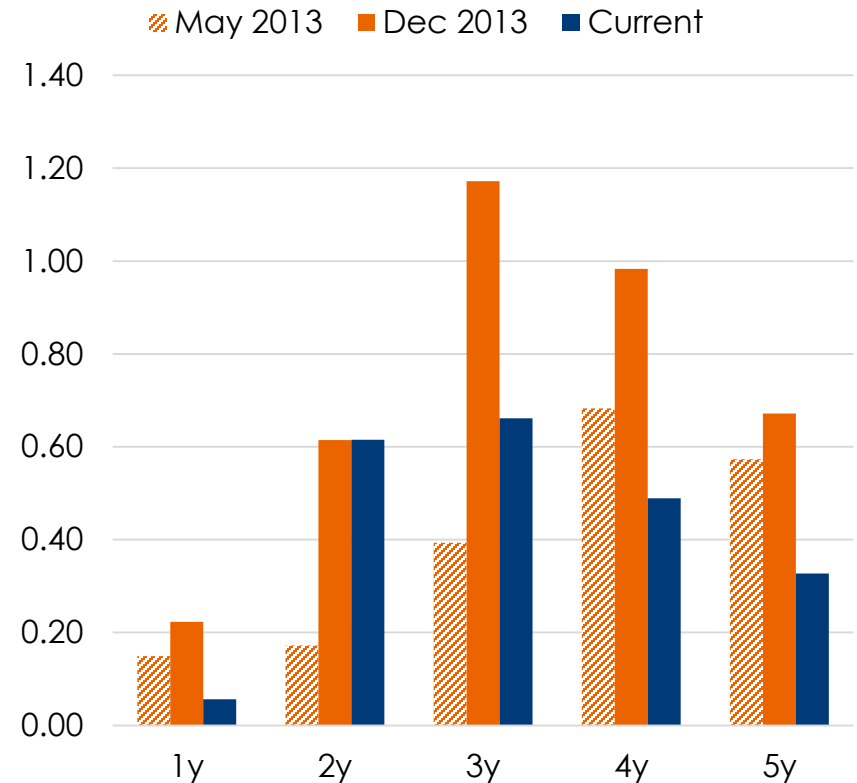
Source: Bloomberg, Intesa Sanpaolo

In 3Q, the Fed will try to prepare the market for lower purchases to avoid an unwarranted shock

5Y1M USD OIS fwd – 1M USD OIS (pb)



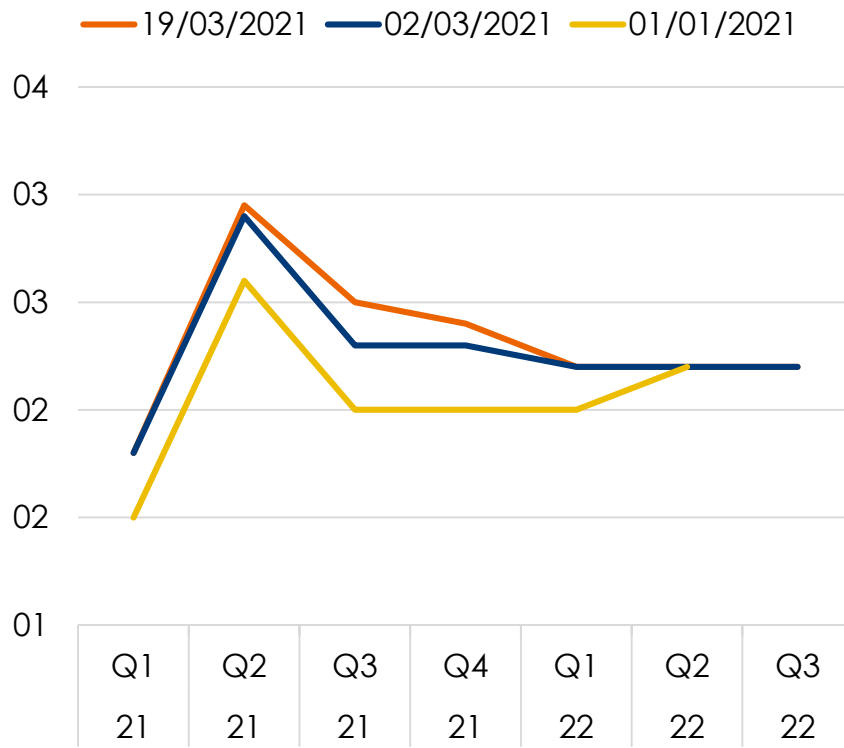
1M tenor USD OIS forward over 5Y horizon (annual change)



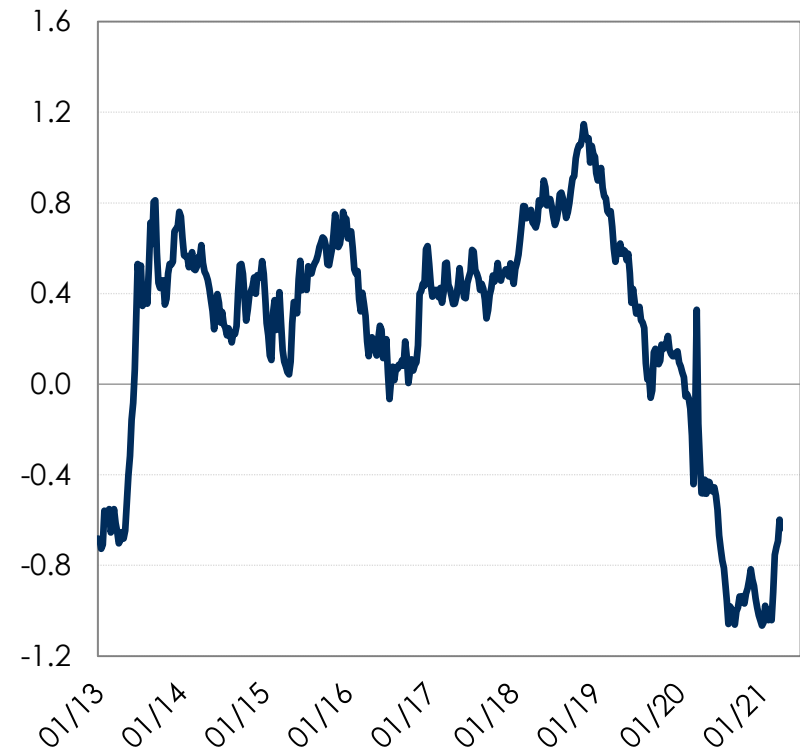
Source: Bloomberg, Intesa Sanpaolo

Q4: growth and inflation falling towards medium-term trend, Fed preparing the next rate hike cycle, 10Y real rates approaching zero

United States - Inflation forecast
(Bloomberg Consensus, yoy)



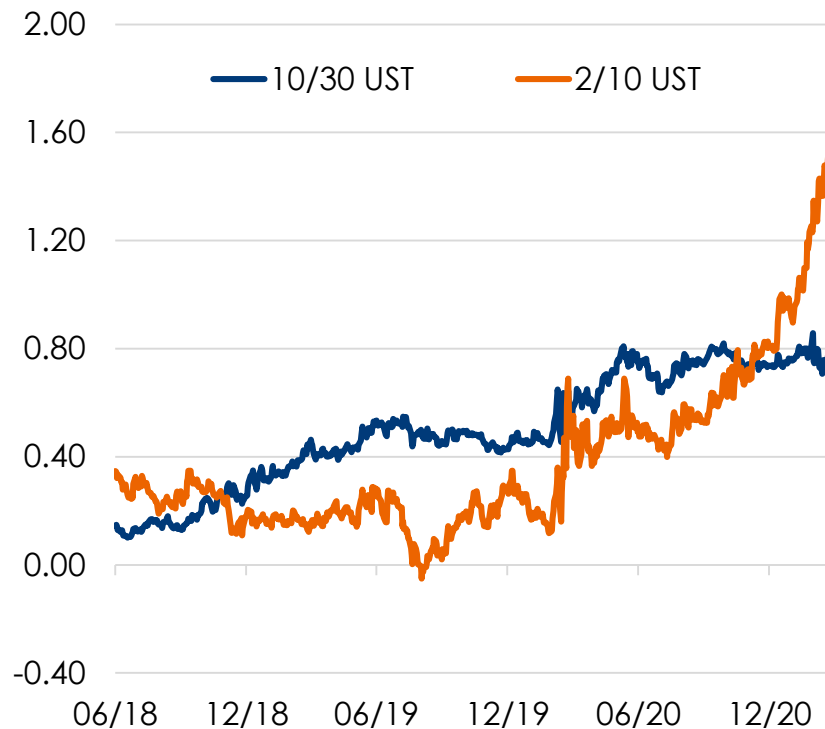
10Y real yield TIPS %



Source: Bloomberg, Intesa Sanpaolo

US Treasury curve: keep short-term steepening bias

US Treasury curve slope (%)



US Treasury curve forward (bp)

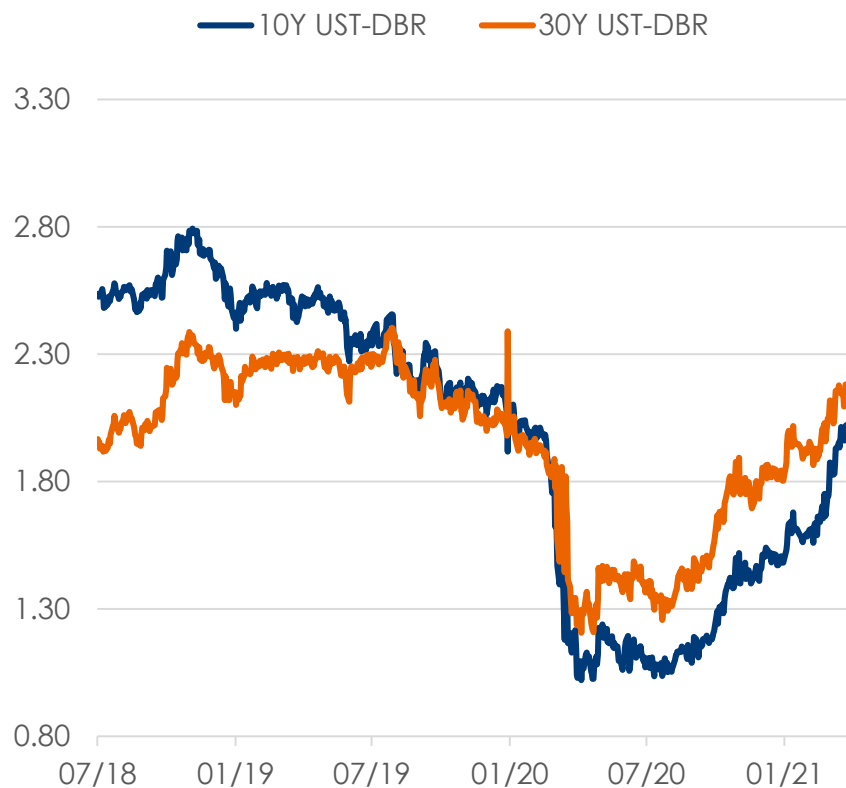
	Spot	Jun 21	Sep 21	Dec 21	Mar 22
2/10Y	154	158	161	164	167
2/5Y	73	76	79	83	86
5/10Y	82	82	82	81	80
10/30Y	70	68	66	64	62

Source: Bloomberg, Intesa Sanpaolo

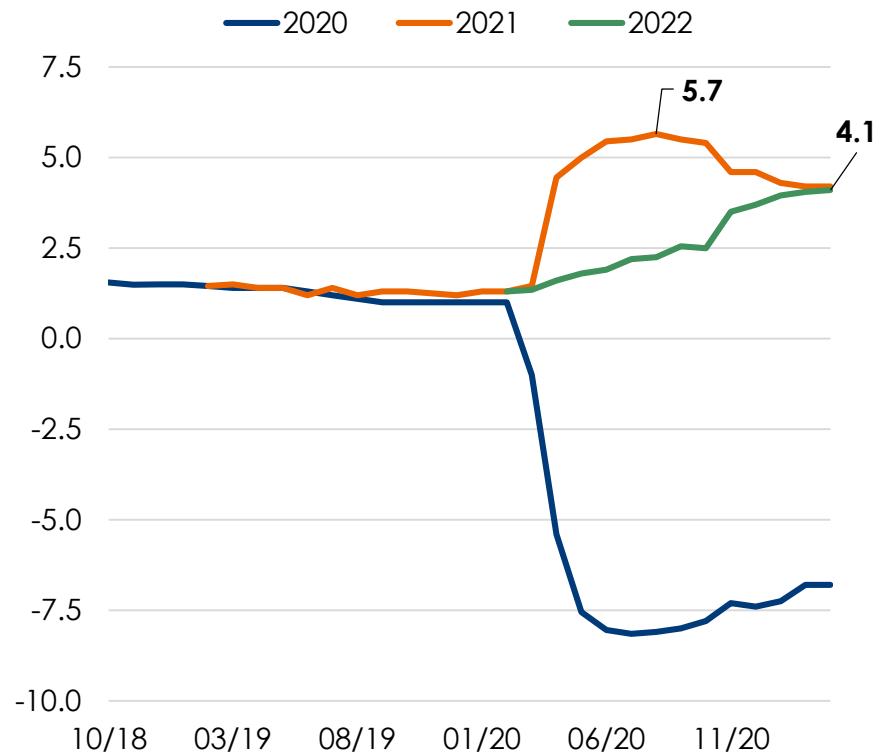
European Govt Bonds

Delayed recovery from the extended lockdowns and slow vaccinations are behind the USD-EUR rate divergence

US Treasury-Bund yield spread (%)



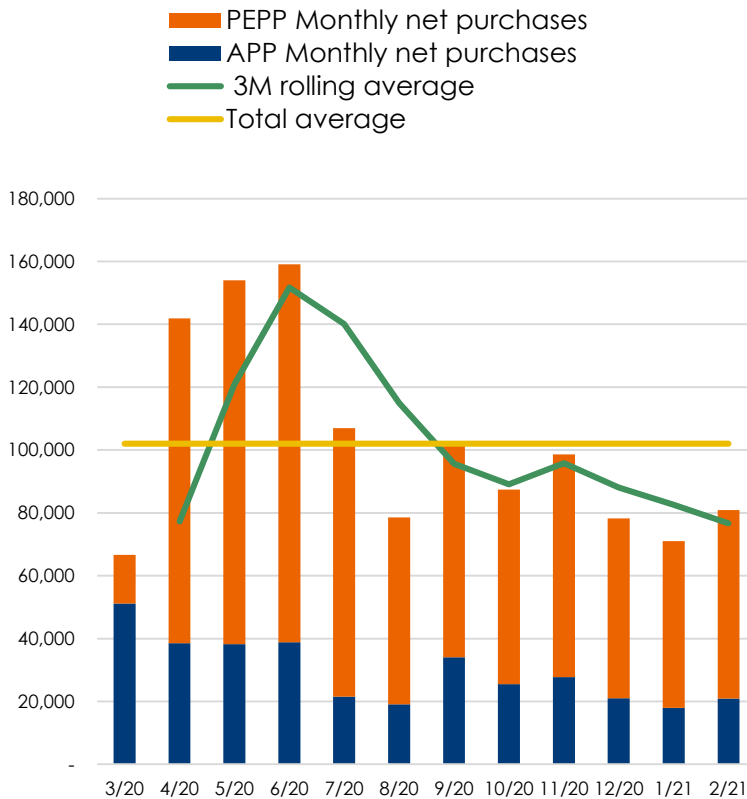
Eurozone Annual GDP growth forecast (Bloomberg Consensus)



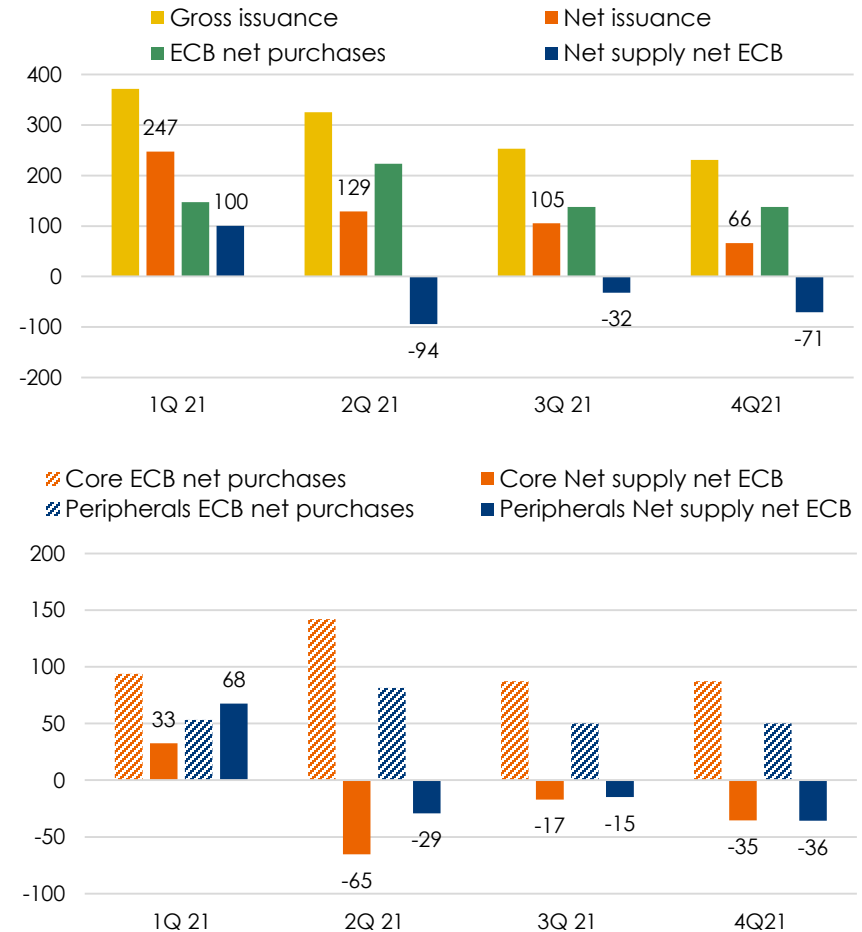
Source: Bloomberg, Intesa Sanpaolo

The ECB controls euro yields with QE and keeps net supply to the private sector deeply negative

Eurosystem: monthly net purchases under APP and PEPP (EUR Bn)



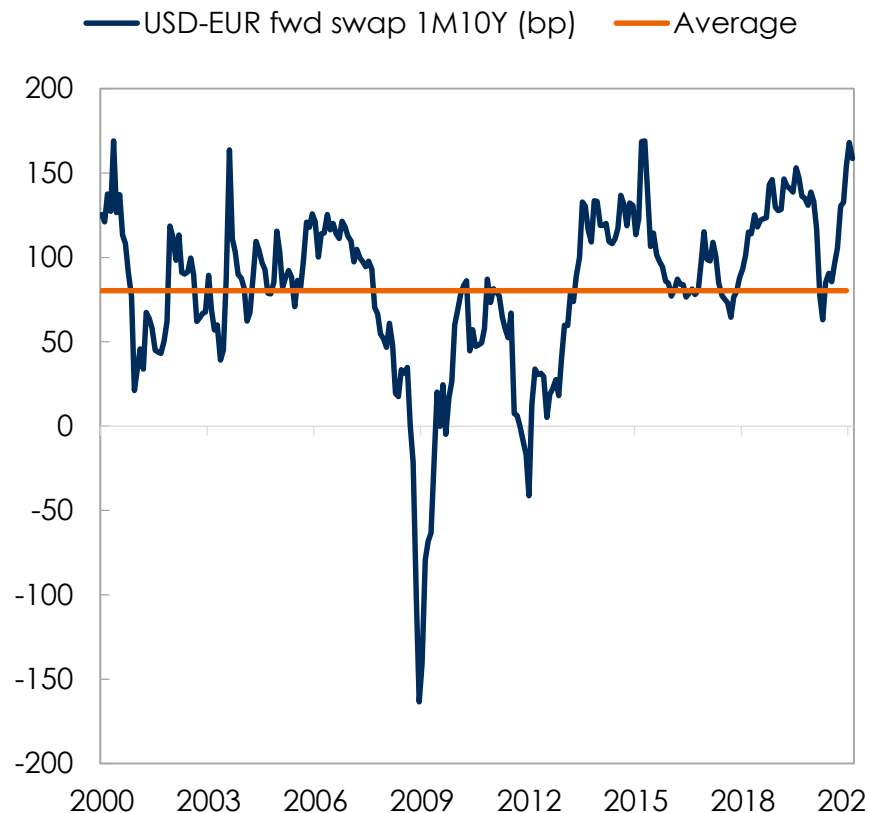
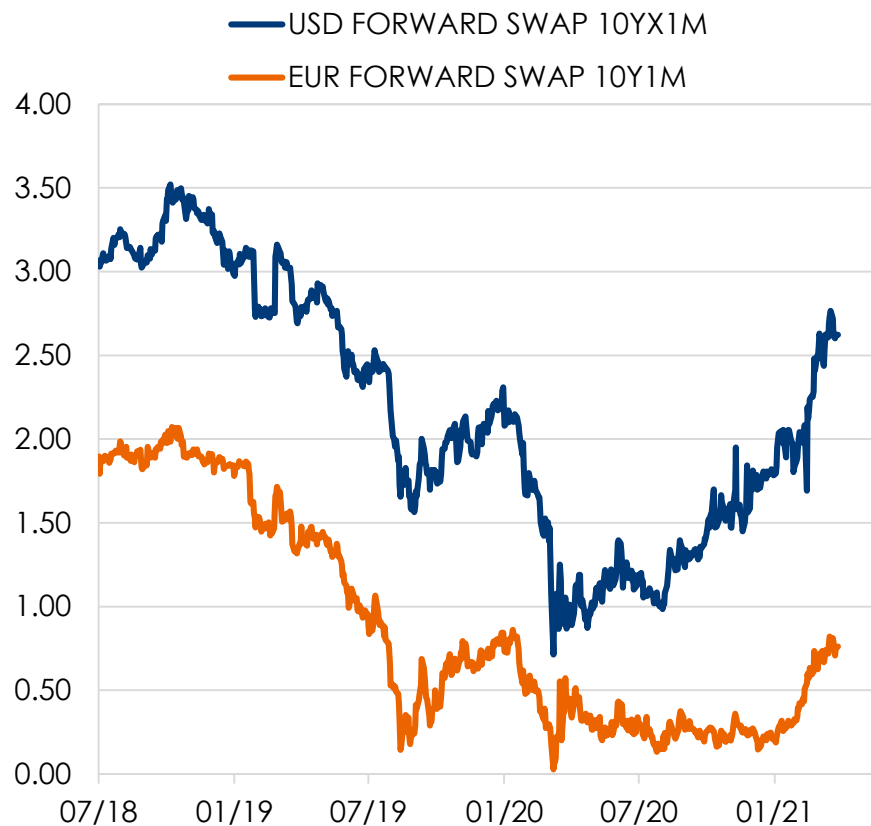
Official net purchases and net issuance (EUR Bn)



Source: ECB, Bloomberg, Intesa Sanpaolo

The divergence between expectations on euro and dollar rates will still be partial

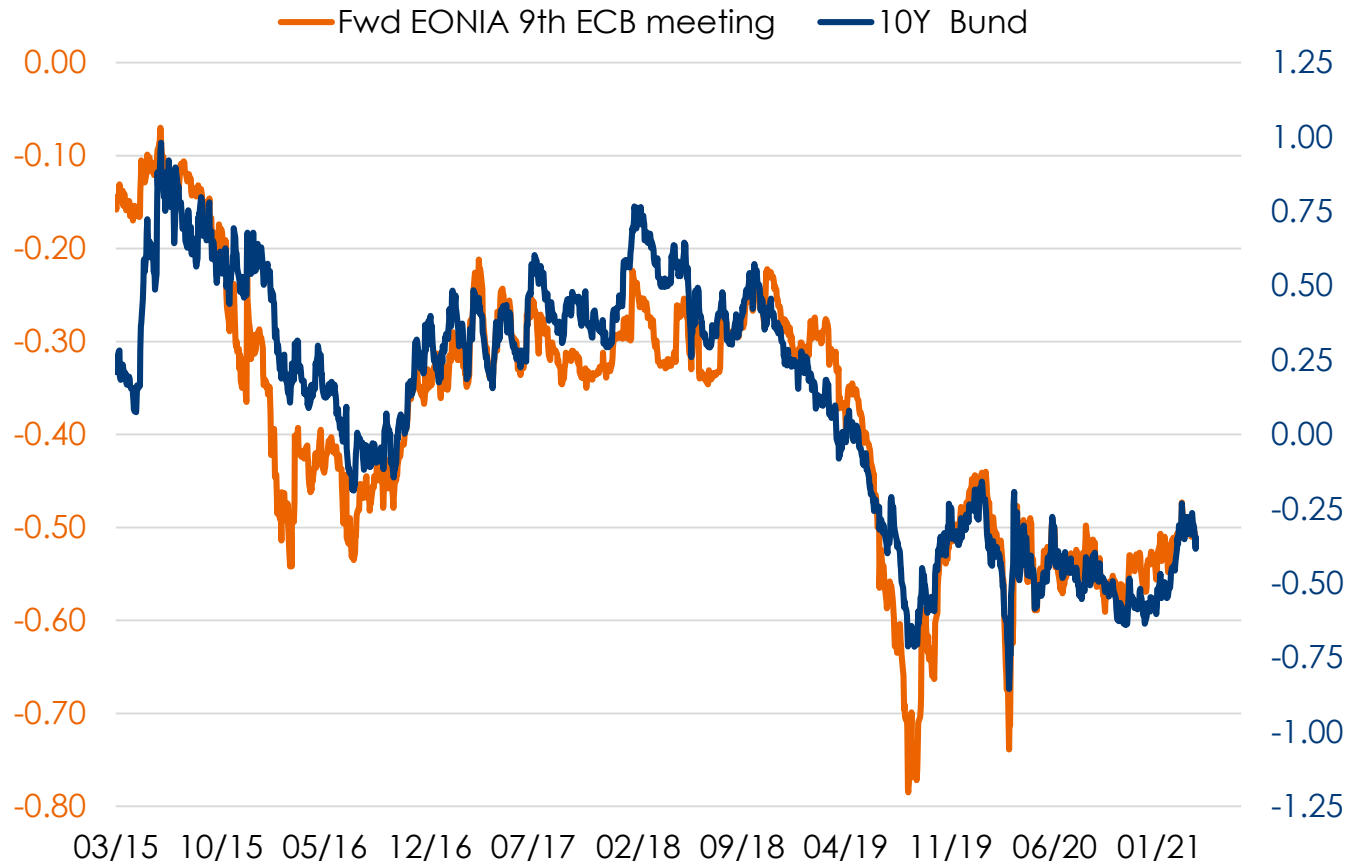
10Y1M USD vs 10Y1M EUR fwd swap (pb)



Source: Bloomberg, Intesa Sanpaolo

10Y Bund is still well anchored to expectations about official rates

10Y Bund and 1Y forward EONIA (%)



Source: Bloomberg, Intesa Sanpaolo

Q3: GDP growth should peak, but the ECB will wait for herd immunity

Interview with Isabel Schnabel, Member of the Executive Board of the ECB, conducted by Klemens Kindermann on 29 January 2021 and published on 31 January 2021

Does this mean that the bond purchases under this emergency programme known as PEPP do not have to be increased again?

That depends on how the pandemic evolves. **The economic performance will largely be determined by how quickly we manage to reach what is known as herd immunity. And this is where vaccination will play a key role.** In December, we already extended our programmes as it was becoming evident that the pandemic would also last a lot longer. We have extended them up until March and June of next year. We do of course hope that that will be enough.

**Introductory statement by Christine Lagarde, President of the ECB, at the Hearing of the ECON Committee of the European Parliament (by videoconference)
Frankfurt am Main, 18 March 2021**

The risks surrounding the euro area growth outlook over the medium term have become more balanced owing to better prospects for the global economy and progress in vaccination campaigns. **However, downside risks remain in the near term, mainly related to the spread of virus mutations and the implications of the ongoing pandemic** for economic and financial conditions.

Source: ECB, Intesa Sanpaolo

Q4: inflation temporarily at its peak, the ECB could unlock yield curves and the UST-Bund differential will start tightening

10Y UST-Bund yield spread (%)



10Y1M EUR fwd swap %

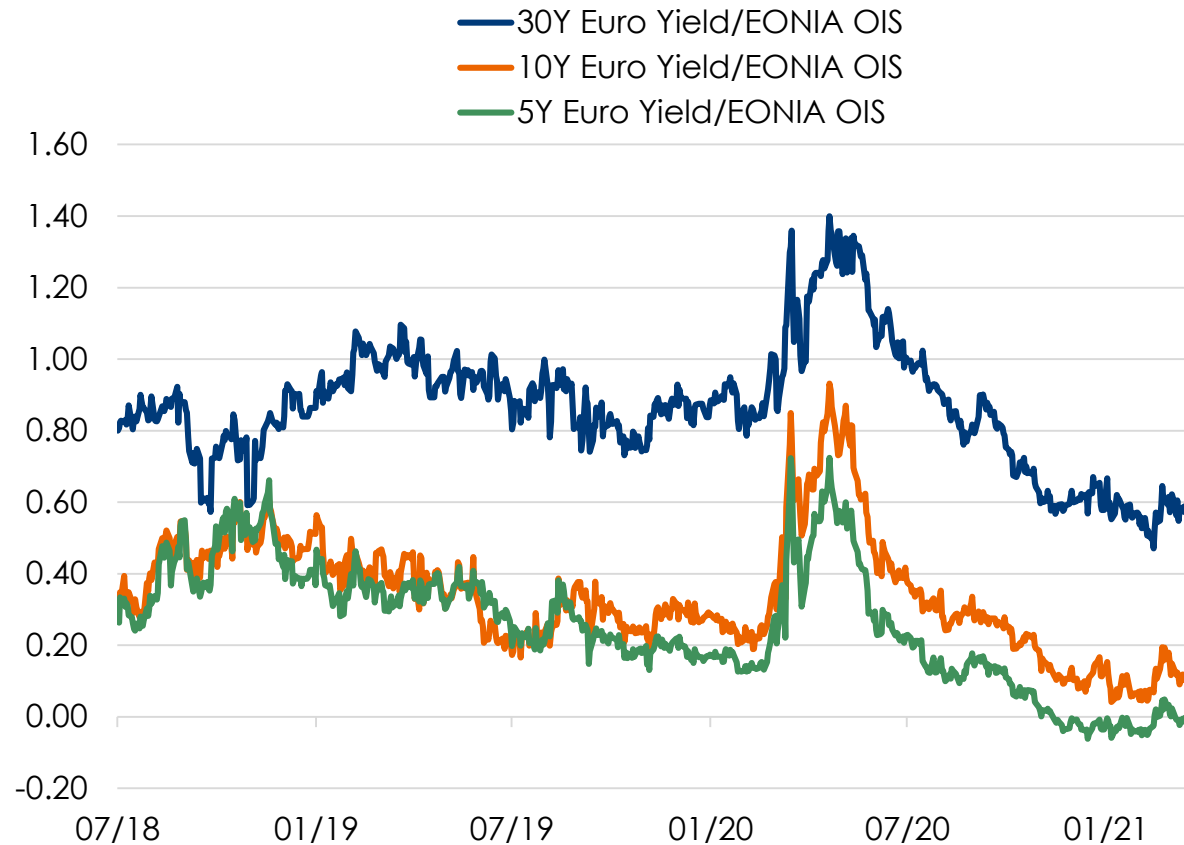


Source: Bloomberg, Intesa Sanpaolo

Intra Euro Spreads

Peripheral and semi-peripheral curves capped by the ECB's informal policy of yield curve control

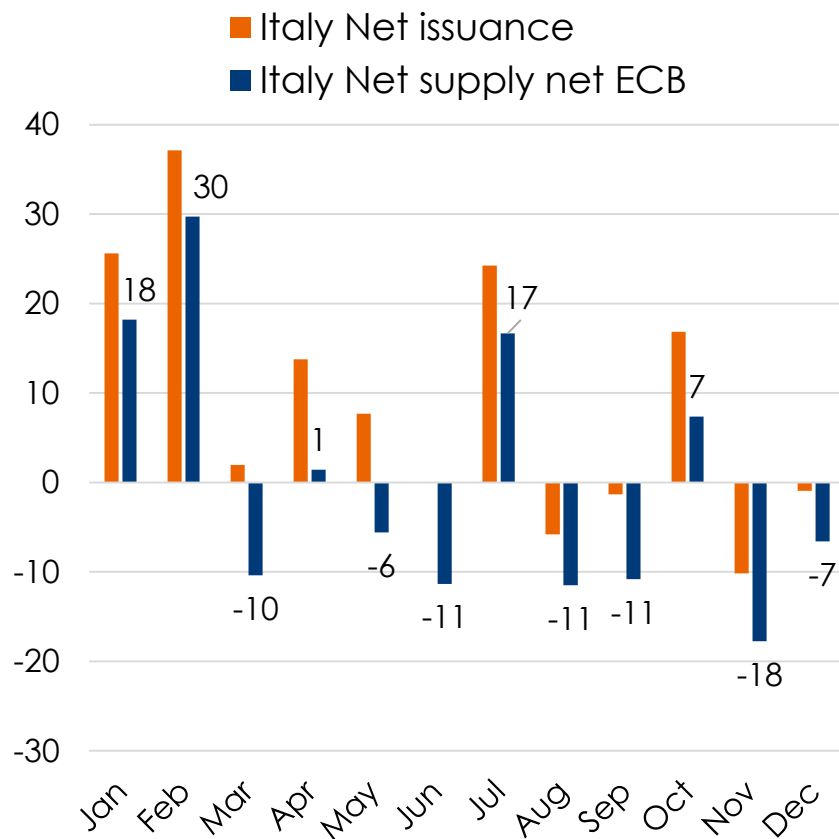
Euro yields (GDP weighted) versus EONIA OIS spreads (%)



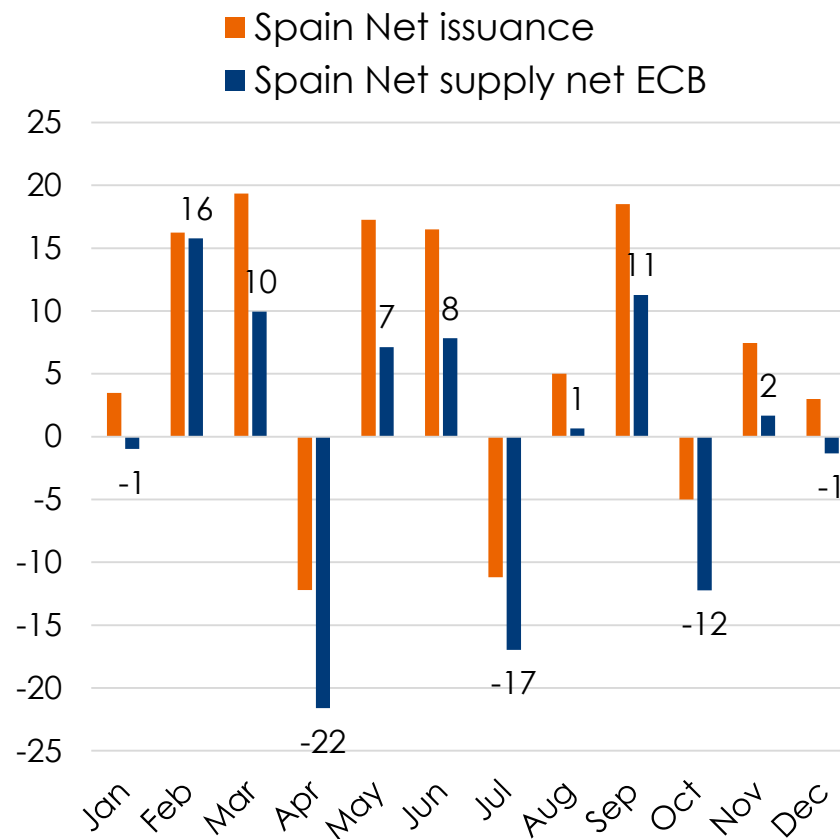
Source: ECB, Bloomberg, Intesa Sanpaolo

BTPs & Bonos: funding risk will ease and search-for-yield dynamics should be supportive near-term

Italy: net issuance net Eurosystem purchases (EUR Bn)



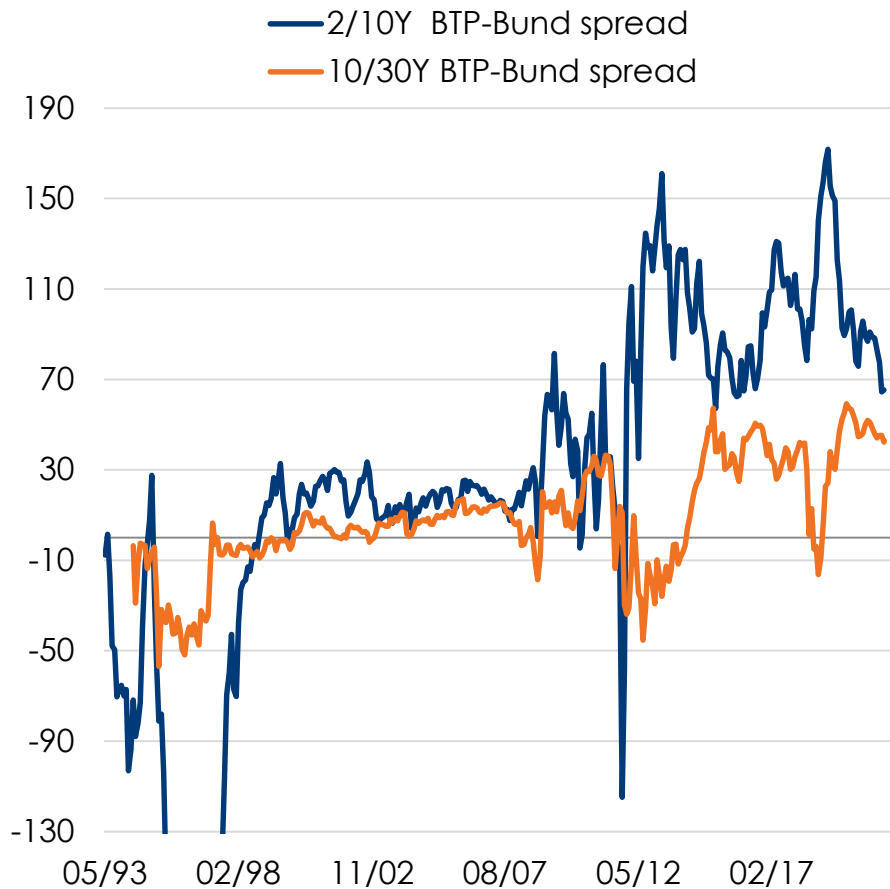
Spain: net issuance net Eurosystem purchases (EUR Bn)



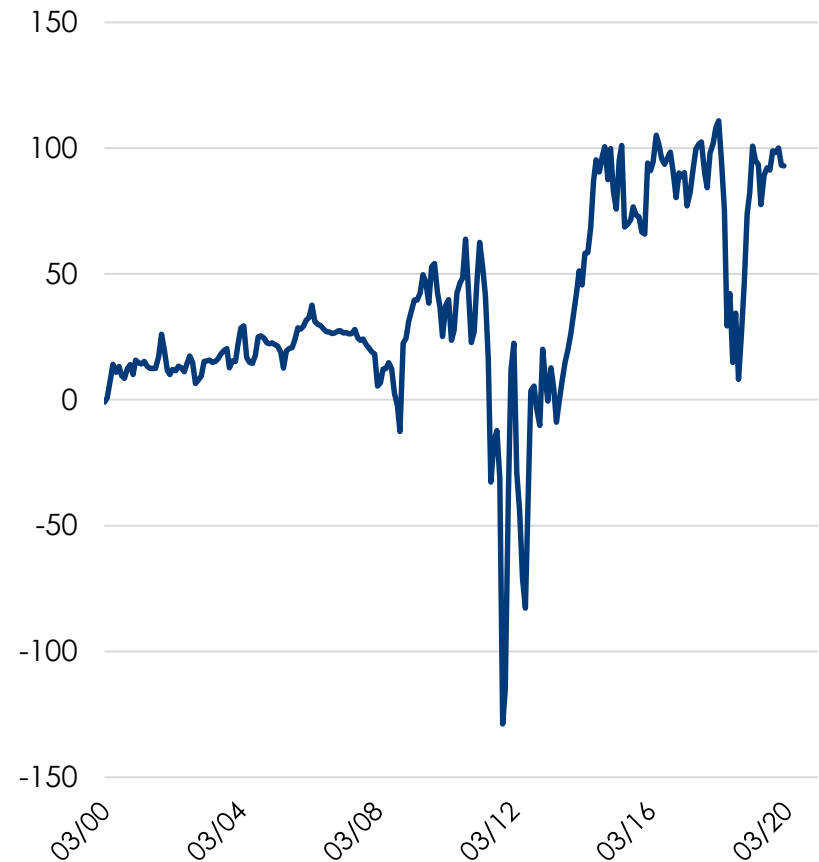
Source: Bloomberg, Intesa Sanpaolo

BTPs: the slope of the credit curve normalized, but the very long-end remains steep

BTP-DBR box spreads (bp)

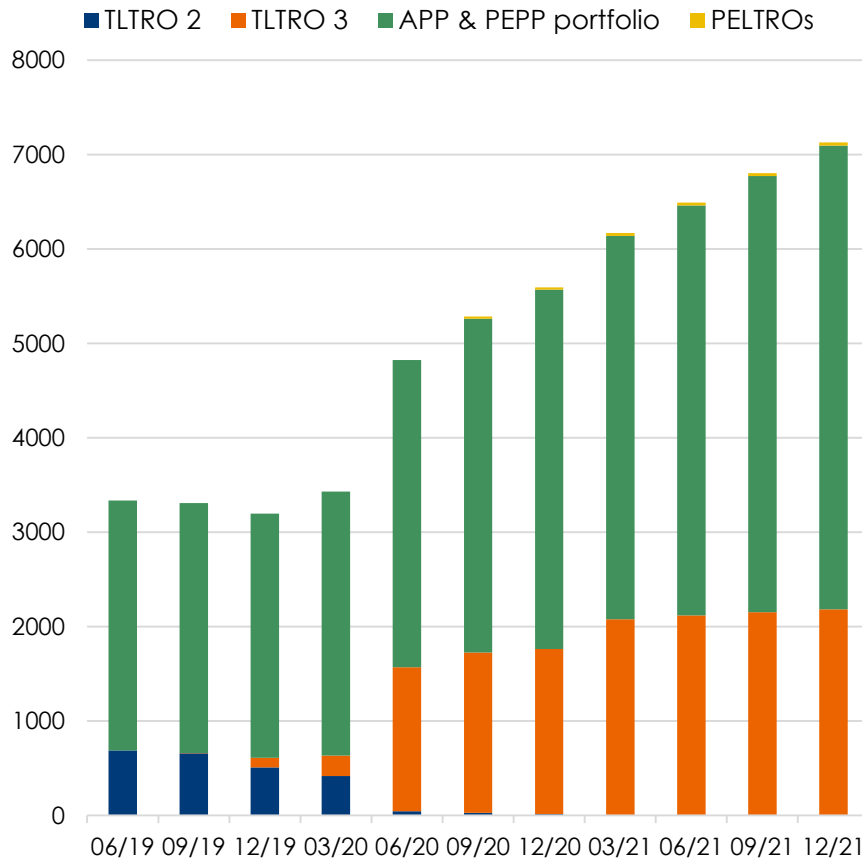


15/30Y BTP-DBR box spread (bp)

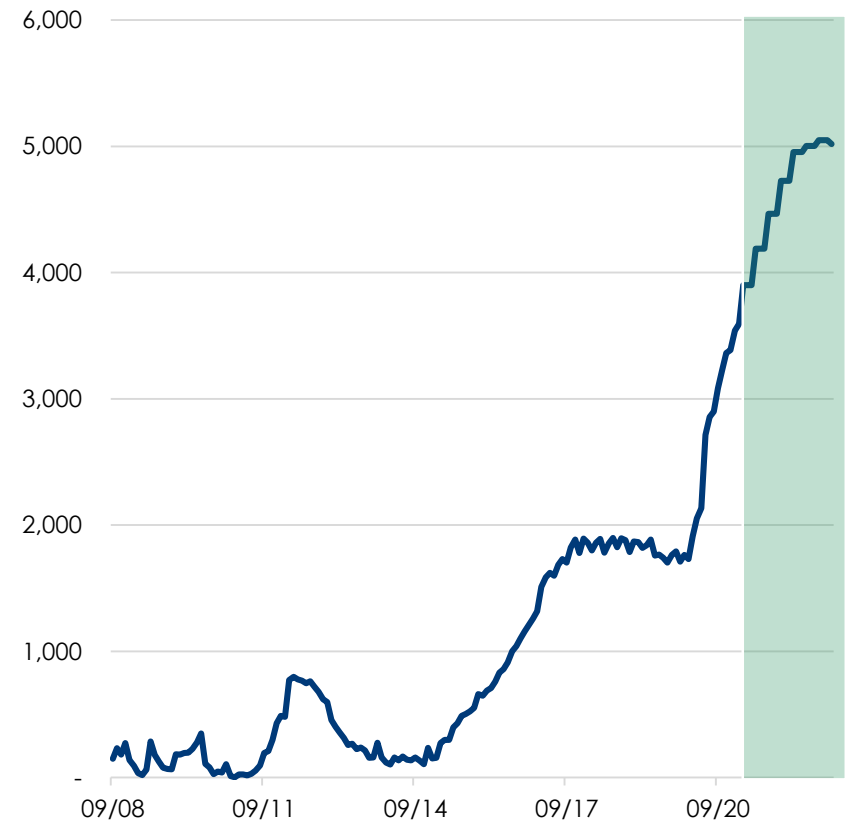


TLTRO III continue to support the front end, excess liquidity will skyrocket toward 5 trillion euros

**Eurosystem assets
(ISP forecast, EUR Bn)**



**Expected excess liquidity of the
Eurosystem (EUR Bn)**



Italian cash deficit is heading towards 180 billion euros this year

Italy - State Sector borrowing requirement and its financing (EUR Bn)

	State Sector	Net Issuance					Total	EU funds and others	Use of cash balance	Treasury Account Balance	
	Deficit (+ deficit / - surplus)	BOTs	CTZs or BTP ST	CCTs	BTPs	Italy Rep				Account & deposits	Sinking Fund
2020	159	15	7	2	137	7	168	8	-17	42	0
2021 F	180	6	10	18	103	-5	133	34	13	29	0
January	4	6	3	0	22	0	31	5	-33	75	0
February	10	-3	3	2	33	0	34	4	-27	102	0
March	28	-1	4	1	0	-3	1	5	22	80	0
April	22	1	4	2	7	-2	11	0	11	70	0
May	27	1	3	2	7	-2	10	6	10	59	0
June	20	0	-10	2	12	-2	1	0	19	40	0
July	15	1	3	2	19	0	24	0	-9	48	1
August	7	1	5	2	-9	0	-2	6	3	46	2
September	20	1	4	2	1	0	7	5	8	37	2
October	15	1	3	2	9	4	18	3	-6	43	0
November	10	0	-12	3	8	0	-2	0	12	31	0
December	2	1	3	2	-5	0	0	0	2	29	0

(*) Forecasts from 28/03/2021

Source: ECB, Bloomberg, Intesa Sanpaolo

Government yield forecasts

US Treasury

	29/03/21	06/21	09/21	12/21	03/22
2Y Forecast	0.14	0.15	0.15	0.30	0.50
Forward		0.21	0.29	0.36	0.45
5Y Forecast	0.86	1.00	1.00	1.10	1.30
Forward		0.97	1.09	1.21	1.33
10Y Forecast	1.67	2.00	1.80	1.90	2.10
Forward		1.73	1.80	1.87	1.95
30Y Forecast	2.37	2.80	2.60	2.70	2.70
Forward		2.37	2.40	2.43	2.45

Slope

2/10Y	154	185	165	160	160
Forward		151	151	151	149
2/5Y	72	85	85	80	80
Forward		75	80	85	88
10/30Y	70	79	83	76	59
Forward		64	60	55	51

US Treasury-Bund Spread

	29/03/21	06/21	09/21	12/21	03/22
2Y	85	85	85	90	95
5Y	153	168	170	160	160
10Y	201	240	220	210	210
30Y	214	260	239	230	210

BTP - Bund Spread

	29/03/21	06/21	09/21	12/21	03/22
2Y	32	30	20	30	40
5Y	65	65	45	70	90
10Y	96	100	80	100	120
30Y	139	145	110	140	160

Bund

	29/03/21	06/21	09/21	12/21	03/22
2Y Forecast	-0.72	-0.70	-0.70	-0.60	-0.45
Forward		-0.74	-0.76	-0.78	-0.79
5Y Forecast	-0.67	-0.68	-0.70	-0.50	-0.30
Forward		-0.66	-0.65	-0.64	-0.62
10Y Forecast	-0.34	-0.40	-0.40	-0.20	0.00
Forward		-0.30	-0.27	-0.25	-0.21
30Y Forecast	0.23	0.20	0.21	0.40	0.60
Forward		0.23	0.24	0.25	0.26

Slope

2/10Y	38	30	30	40	45
Forward		44	49	54	58
2/5Y	5	2	0	10	15
Forward		8	11	14	17
10/30Y	57	59	61	59	56
Forward		53	51	49	47

OAT-Bund Spread

	29/03/21	06/21	09/21	12/21	03/22
2Y	9	10	5	5	10
5Y	7	10	13	13	20
10Y	25	25	20	20	30
30Y	56	56	51	51	61

Bonos-Bund Spread

	29/03/21	06/21	09/21	12/21	03/22
2Y	21	20	15	20	25
5Y	36	40	25	40	50
10Y	64	70	50	60	70
30Y	100	110	90	90	105

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