

After the deluge, the skies begin to clear

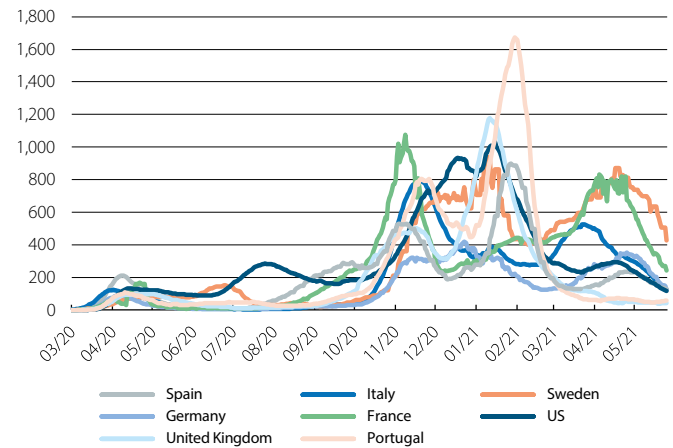
There are good reasons to be optimistic. In recent weeks, the health data and economic activity indicators have led to a shower of optimism in the major advanced economies, resulting in an upward revision of the growth forecasts for 2021 and 2022. The reopening of domestic mobility and the easing of restrictions between countries (which is fundamental for Europe), as well as the lifting of closures and longer opening hours among catering establishments and a gradual increase in hotel occupation rates, reinforce expectations for a brighter middle of the year in advanced economies.

The vaccine is reinforced as the decisive weapon in the fight against COVID-19. The key behind this improvement is the sprint in the vaccination campaigns in the developed world. At the current rate, herd immunity could be achieved this summer. In June, it is expected that over 50% of the population in Europe will have received at least one dose, and over 60% in the US. The main risk now is that the vaccines could lose their effectiveness with the new variants of the virus, which are still very present in many countries. The mutation spreading across India is the most worrying at present, as it is more contagious and also has a higher mortality rate. The war against the pandemic is global and, for the moment, battles are only being won in rich countries with access to the vaccines.

ADVANCED ECONOMIES

The gaps between both sectors and countries are narrowing. The brighter outlook is very visible in surveys and high-frequency indicators published since April, in terms of both mobility and economic activity. The sings of revival are widespread, especially in the services sector (i.e. they are no longer limited to industry), but they are also noticeable in countries lagging further behind. In the US, GDP is expected to exceed pre-pandemic levels in this second quarter. However, even in the US, which is ahead of the curve, some sectors continue to suffer and the labour market still has a long way to go. For instance, there are still some 8 million fewer people working than there were at the start of the crisis. Although some of them have left the labour market permanently (some baby boomers have decided to retire early), it is estimated that there are around 3 million people who have left the market for reasons such as caring for people. The labour market will remain the weak point of the global recovery for some time to come: including furlough schemes, in developed economies alone some 30 million jobs have been lost, according to estimates by *The Economist*.

Cumulative COVID-19 cases
(14-day cumulative number of cases per 100,000 inhabitants)



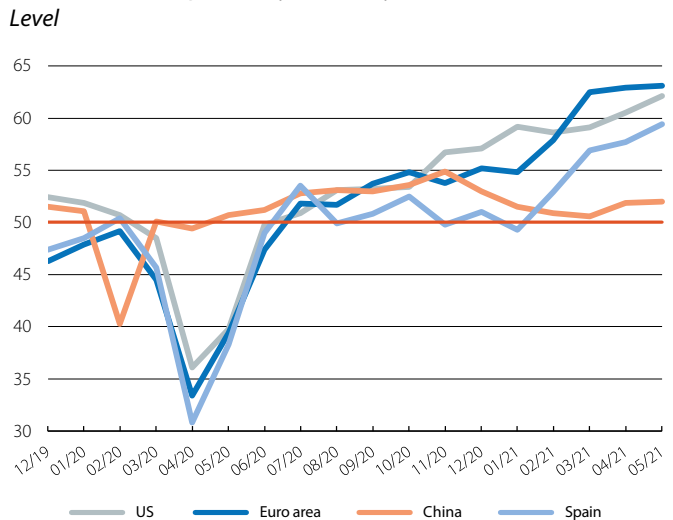
Note: Data available up until 27 May 2021.
Source: CaixaBank Research, based on data from the Spanish Ministry of Health, Johns Hopkins CSSE and UN World Population Prospects.

Vaccination around the world

	Date of latest data	Doses delivered	% of population vaccinated	Doses in last week per 100,000 inhabitants
Israel	26 May	10,571,337	62.9	304
United Kingdom	25 May	61,995,062	56.5	6,097
Canada	26 May	21,939,046	53.5	6,609
Chile	25 May	17,794,484	52.2	4,526
US	26 May	289,212,304	49.4	3,565
Germany	26 May	47,358,842	41.5	5,515
Spain	25 May	25,592,991	36.8	4,701
Italy	26 May	32,368,381	36.3	5,645
Portugal	26 May	5,317,986	36.0	4,985
France	25 May	33,681,416	35.2	4,956
Poland	26 May	18,785,240	34.7	5,209
Denmark	26 May	3,202,613	34.3	5,599

Source: CaixaBank Research, based on data from the Spanish Ministry of Health and Our World in Data - Oxford University.

Manufacturing PMI by country



Source: CaixaBank Research, based on data from Markit.

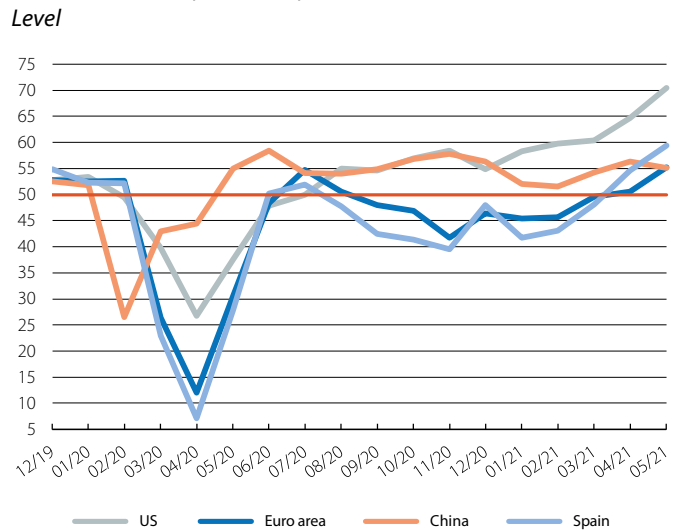
Spring also arrives in Europe's economies. The data give a clear signal that the euro area has overcome the latest turbulence and that the downside risks in the growth outlook have cleared. Indeed, the balance of risks is now broadly positive, especially for 2022, as reflected in our new forecasts. What is perhaps harder to believe is that the improvement in the euro area is here to stay, given how accustomed we have become to disappointment. But the truth is that the revival looks strong (for instance, in May the expectations component of Germany's Ifo index reached its highest level since 2011) and this will allow the gap between the two major Atlantic economies to narrow. Growth in the US in 2021 will be much higher than in the euro area (6.5% compared to 4.2%, according to our estimates, both revised upwards this month). However, that is more a reflection of past events (GDP declines in the euro area in Q4 2020 and Q1 2021) than of the present and what is to come: providing there are no negative surprises, euro area growth in the mid-year quarters of 2021 could even outperform that of the US.

New fiscal stimuli are expected on both sides of the Atlantic. The Biden administration remains highly active and has proposed two new long-term (10-year) fiscal packages amounting to a total of 4 trillion dollars (approximately 20% of GDP), one related to infrastructure and the other in the social sphere. Europe is also starting to make moves: countries have already presented their programmes in order to receive funds from the Recovery Plan, which could begin to be disbursed as early as July, providing an important stimulus for Southern and Eastern Europe. In this context, the European Commission raised its growth forecasts for the EU in 2021 and 2022 and confirmed that the stability and growth pact will remain on hold until 2023, reducing the risk of a premature withdrawal of the support for weaker economies. In any case, there is little doubt that the fiscal rules will need to be rethought, as the vast majority of countries have exceeded their target debt levels and some have more than doubled them.

Are major political changes looming in Germany? Germany's upcoming legislative elections in September are also in the spotlight, as the latest polls suggest a technical tie between the CDU and the Green Party. Right now, a coalition government between the two forces appears to be the most likely outcome. *A priori*, this would be a balanced government, with more sensitivity towards Europe and favourable to handing over more powers to Brussels (the ability to collect revenues and issue bonds) and greater investment in infrastructure and new technologies. It could therefore strengthen the Franco-German axis and have a greater chance of implementing major EU reforms.

Upside inflation risks also materialise, especially in the US. As we have been warning about, inflation rising above the US and euro area central banks' target rates was almost

Services PMI by country



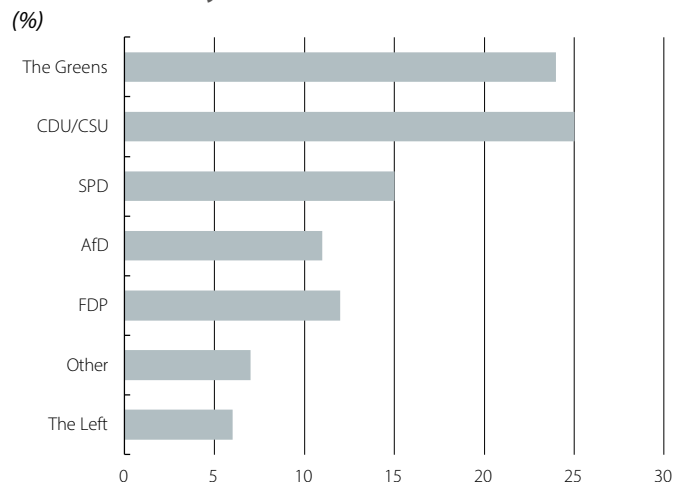
Source: CaixaBank Research, based on data from Markit.

European Commission forecasts

	GDP		Inflation		Public debt		Fiscal balance	
	Annual Δ (%)		Annual Δ (%)		(% of GDP)		(% of GDP)	
	2021	2022	2021	2022	2021	2022	2021	2022
Euro area	4.3	4.4	1.7	1.3	102.4	100.8	-8.0	-3.8
Germany	3.4	4.1	2.4	1.4	73.1	72.2	-7.5	-2.5
France	5.7	4.2	1.4	1.1	117.4	116.4	-8.5	-4.7
Italy	4.2	4.4	1.3	1.1	159.8	156.6	-11.7	-5.8
Spain	5.9	6.8	1.4	1.1	119.6	116.9	-7.6	-5.2
Portugal	3.9	5.1	0.9	1.1	127.2	122.3	-4.7	-3.4

Source: CaixaBank Research, based on data from the European Commission (European Economic Forecast, Spring 2021).

Germany: if the parliamentary elections were this Sunday, I would vote for...



Source: CaixaBank Research, based on data from POLITICO Research (28 May 2021).

a certainty, given the base effects at play. Nevertheless, in the US the debate has heated up after headline inflation rose above 4% in April (much higher than expected), while core inflation stood at a high 3.0%, driven up by the rise in demand and the bottlenecks that are beginning to be felt in some sectors. In this context, the impact on bond yields is nevertheless contained, most likely due to moderation in the pace of job creation (+266,000 in April compared to 770,000 in March). In our case, the much higher than expected April figure has led us to substantially revise our US inflation forecasts (3.2% on average for the year, compared to the previous 2.7%). However, we still believe that the rebound in inflation will be temporary (with the peak in May). In particular, we expect to see a gradual decline beginning in the summer, with inflation reaching close to 2% in the second half of 2022.

In the euro area, the stress on inflationary is more contained.

Inflation rose in April to 1.6% from 1.3% (in line with our forecasts). In the short term it will continue to rise (we expect it to reach a high of slightly more than 2.5% at the end of the summer), before falling back down and reaching around 1.5% by Q2 2022. However, risks of higher inflation continue to dominate the outlook, especially in the US. Significant and unique factors support the hypothesis of persistently high rates: i) a historic acceleration in economic activity, following a similarly historic collapse (global growth will approach 6.0% in 2021, compared to -3.3% in 2020); ii) large quantities of household savings; iii) evidence of supply-side restrictions in some sectors, and iv) unprecedented fiscal and monetary stimuli. Increasing speculation can therefore be expected about the timing of the reduction in the monetary stimuli, which will certainly be earlier in the US than in the euro area and will trigger nerves in the financial markets (see the Financial Markets section for details about the Fed and the ECB).

EMERGING ECONOMIES

More erratic signs in emerging economies. Unlike developed countries, emerging countries have shown mixed and somewhat erratic signs in recent weeks. However, China remains the centre of attention, where policymakers are prioritising elements such as financial stability in a context of strong anticipated growth in 2021 (8.3%). In this regard, the latest movements suggest a relative improvement in the quality of debt among corporate bonds, as well as strong demand for private credit. On the other hand, the foreign sector remains a strength for the Asian economy and is favoured by the global recovery. In the medium term, the 19th National Congress of the Chinese Communist Party in October showed that the authorities are aware of the imbalances in China's growth, with an excessive role of state investment in heavy industry and excessive carbon emissions, but the country's economy has significant inertia.

US: CPI

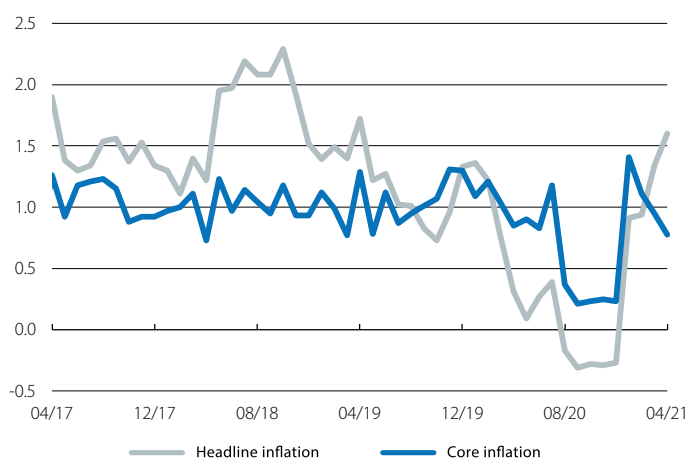
Year-on-year change (%)



Source: CaixaBank Research, based on data from the Bureau of Labor Statistics.

Euro area: CPI *

Year-on-year change (%)

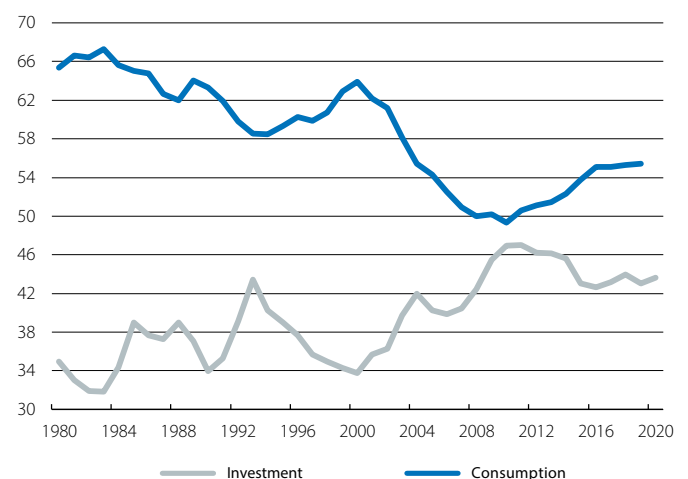


Note: * Data corresponding to the HICP.

Source: CaixaBank Research, based on data from Eurostat.

China: investment and consumption

(% of GDP)



Source: CaixaBank Research, based on data from the IMF.