GROWING CERTAINTY THAT THERE WILL BE LESS UNCERTAINTY

In many countries the number of new Covid-19 cases has begun rising again, forcing governments to maintain or tighten health restrictions. This is the case for the Eurozone, among others, where a true rebound in growth and demand has been postponed yet again. The timing of the recovery will depend essentially on the effectiveness of restrictive measures and the acceleration of vaccination campaigns, but also on spillovers effects with some of its trading partners whose economies are picking up more rapidly. The United States is one such country thanks to its successful vaccination campaign and the enormous recovery plan that has just been launched. America's influence is not limited to providing greater opportunities for European exporters. The upturn in US bond yields has partially carried over to long-term rates in the Eurozone, pushing them higher. This trend largely reflects higher inflation expectations, although the Federal Reserve is convinced that the surge in inflation will be short-lived. Companies and households should welcome the bond markets' jitters, which clearly signal the sentiment that the economy really is improving.

In late 2020, there were high hopes that the health crisis would soon improve and that economic activity would rebound in its wake. In many countries and regions around the world, the actual situation was a big disappointment as the number of new Covid-19 cases began rising again, forcing governments to maintain or tighten health restrictions. The Eurozone is a case in point. Although Q1 GDP growth is expected to be positive on a quarterly basis, it is mainly due to the growth pick-up in the latter part of the fourth quarter of 2020. A real rebound in economic growth and demand has been postponed again, and its timing will depend mainly on the effectiveness of restrictive measures and the acceleration of vaccination campaigns.

DESYNCHRONIZATION IN THE REAL SPHERE

Another source of hope that will play a non-negligible role is the spillover effect of certain trading partners like the United States, but also China and the UK, which has already begun to ease health restrictions. In the US, high hopes for a successful rollout of vaccination campaigns earlier this year were largely surpassed. Economic growth was already beginning to recover, and will now receive another immense stimulus through the USD 1.9 trillion recovery plan. Although many disagreed with the size of the package, there was clearly a need for fiscal support, given the enormous gap between the number of Americans who managed to preserve their job or find a new one and pre-pandemic employment levels. The longer it takes to close the gap created by job destructions, the greater the risk that the pandemic will have hysteresis effects that leave a lasting negative impact. In the months ahead, Congress will begin debating a new plan that primarily targets the supply-side of the economy, including investment in infrastructure, the digital world, and innovation, with a bent towards preparing for climate change.

The Eurozone will benefit from the desynchronization of economic momentum with the United States. In economic surveys, companies are already expressing optimism about exports. This is especially true for Germany. The strong rise in the March surveys is also striking. The European Commission's economic sentiment survey is now very slightly higher than its long-term average, buoyed by brighter sentiment in several sectors (industry, services, retailing and construction) as well as among households. April's figures are unlikely to be as strong due to the introduction of new health restrictions, but the recent momentum in the surveys suggests that companies and households alike are increasingly seeing the glass as half full. There is growing certainty that uncertainty will decline. After all, the restrictive health measures and vaccination campaigns will eventually pay off.

US : TOTAL NON-FARM EMPLOYMENT

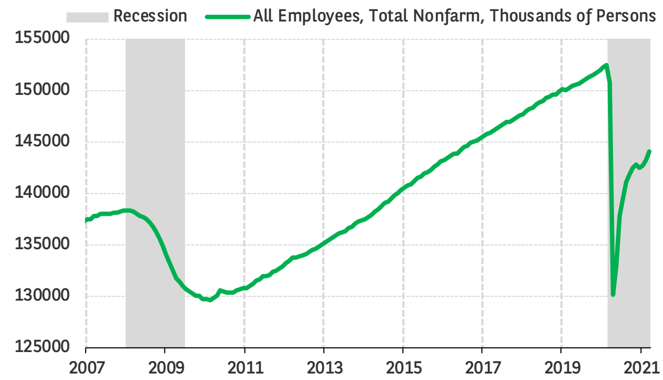

CHART 1

SOURCE: FEDERAL RESERVE BANK OF ST. LOUIS, BNP PARIBAS

SYNCHRONISATION IN THE FINANCIAL SPHERE

Naturally, the bond markets have not been indifferent to these developments. In the United States, 10-year Treasury yields have continued to rise, building on a trend that started last summer. Initially they reflected the higher inflation expectations of investors, although more recently, real rates have risen, buoyed by the US recovery plan. As usual, this momentum carried over to bond yields in other countries, including those of the Eurozone. As a result, the ECB had to accelerate the pace of its sovereign bond purchases to avoid a tightening of financing conditions, which would have been particularly unwelcome. The Federal Reserve remains stoic in the face of the bond markets' behaviour, although it admits that inflation will rise in the second half. There are several arguments: corporate surveys are already showing a net increase in input prices, and a strong acceleration in growth will inevitably lead to a supply and demand imbalance, since supply chains still bear the scars of last year's disruptions and, at least in the short run, will not be able to keep up the pace. Even so, the Fed considers that the surge in inflation will be short-lived. Supply will adapt and inflation expectations seem to be well anchored. This is a crucial factor for wage negotiations and price setting trends. The months ahead risk being caught in a tug of war between the bond markets and the Federal

Reserve. The Fed's communication policy will have to strike a very fine line to avoid throwing more oil on the fire. Companies and households should welcome the bond market's jitters, which clearly signal the sentiment that the economy really is improving.

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BREAK-EVEN INFLATION IN THE US AND IN GERMANY

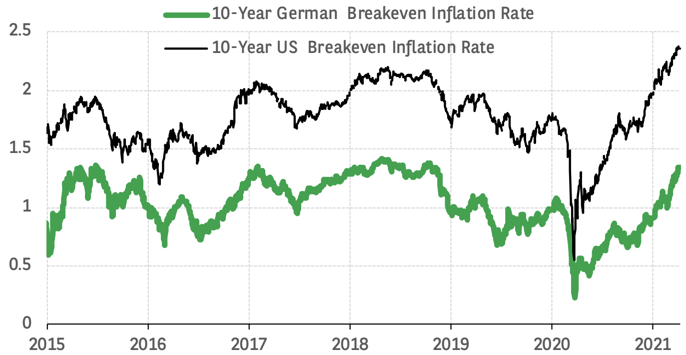

CHART 2

SOURCE: BLOOMBERG, BNP PARIBAS