Economic Outlook

Eurozone, US and Emerging Markets

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Economic Expansion Enters the Next Phase

Focus of recovery shifts to services

Thanks to rapid progress in vaccination rates in industrialized countries, the recovery is entering the next phase. In the US and the EU a sustainable reopening of the services sector has already been implemented. The biggest risk to the economic outlook in the 2nd half of the year would be a breach of the current immunization of the general population by a virus mutation, which could make a renewed imposition of restrictions necessary.

Dynamic recovery of euro zone economy in H2

Following the lifting of restrictions, we expect a dynamic recovery of the euro zone economy in H2. We are forecasting GDP growth of 4.4% in 2021. Funds from the EU recovery and resilience facility will help countries such as Italy and Spain achieve a substantial growth spurt in 2022. We therefore expect growth momentum in the euro zone to remain at a high level of 4.1% in 2022. Even after 2022, the investments and reforms of the EU recovery plan will boost growth in these countries noticeably. This should have a favorable effect on financing costs in Italy and Spain in the long term and thus improve the stability of the euro zone.

Transitory surge in euro zone core inflation in the 2nd half of the year

In H1, energy prices were the main driver of rising headline inflation in the euro zone. Upward pressure from energy prices should ease in H2 as base effects fade. Due to special effects related to the pandemic, we expect core inflation to exert temporary upward pressure on headline inflation in H2. However, In the medium term labor market developments will remain the decisive driver of sustainable inflation trends in the euro zone. Due to the impact of the pandemic, we believe an oversupply of labor will persist at least until the end of 2022. Therefore we do not expect sustained upward pressure on wages and prices in the euro zone before 2023 at the earliest.

Economic boom in the US

As expected, strong economic growth was posted in the first quarter on the back of two economic stimulus programs. The second stimulus package, in combination with further steps to open up the economy, at a minimum suggests that economic growth will accelerate again in the second quarter. The outlook for the third quarter, which has just begun, is positive as well. The US economy is in a phase in which it is massively boosted by stimulus programs and steps toward reopening economic activity. While the associated effects could weaken somewhat, the third quarter is still expected to exhibit strong growth. However, from the perspective of market participants the decisive issue is not economic growth, but rather inflation.

Global Economy

Progress in vaccination rates facilitates reopening of services sector

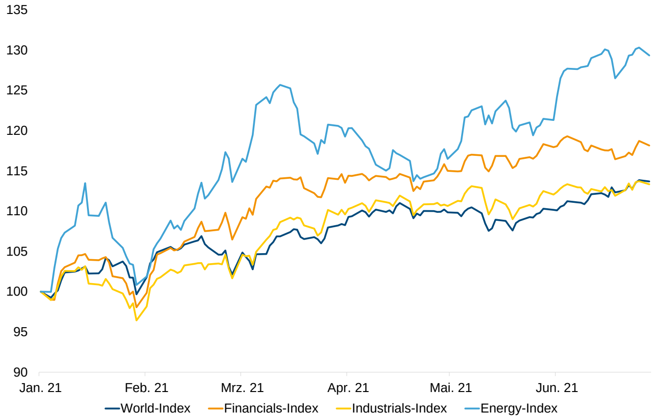
The recovery of the global economy will continue in the 2nd half of the year. From a regional perspective the pace of the recovery varies and is affected by differences in the progress of vaccination coverage and different levels of fiscal support. Thanks to the substantial progress already achieved with respect to vaccination rates in the US and the EU in the 1st half of the year, the services sector in numerous countries can be reopened in a sustainable manner. This will shift the focus of the global recovery from manufacturing to services in H2. The biggest risk for the outlook would be a virus variant that breaches the protection provided by vaccinations and could therefore trigger renewed restriction measures.

Financial markets confirm positive economic outlook

Global stock markets are currently confirming the positive growth outlook for the 2nd half of the year. Since the beginning of the year, cyclical sectors such as industrials, energy and financials have performed equally well or even better than the broad market for the first time in a long time. Analysts expect these sectors to post the most significant earnings growth this year as well. A similar picture is evident in the corporate bond market, where credit spreads on high-yield bonds have tightened further since the beginning of the year. From the perspective of investors, the positive growth outlook has reduced the risk of credit defaults by high-yield issuers.

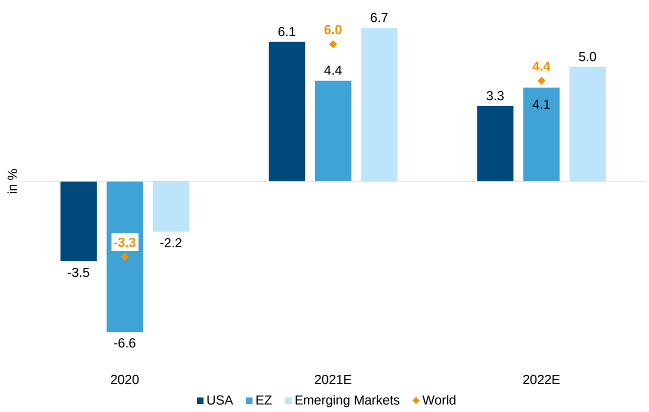
Inter alia due to shortfalls in their progress with vaccination coverage, investors are also slightly less enamored with emerging markets than with developed countries this year. However, we expect the pace of vaccination efforts in emerging markets to accelerate in the 2nd half of the year. In line with this, growth prospects for the services sector in emerging markets should also improve in coming months. Growth in euro zone exports will benefit from this. Furthermore, statements and announcements by the US-Fed will be of major importance for emerging markets in H2.

Cyclical sectors: above-average returns
Sector indexes Erste Group (2021performance)



Source: Market data providers, Erste Group Research

Strong recovery expected in 2021
GDP growth 2020 - 2022E



Source: IMF, Erste Group Research

Euro Zone Economic Outlook

Dynamic recovery expected from 2Q 2021

Services sector rebounding

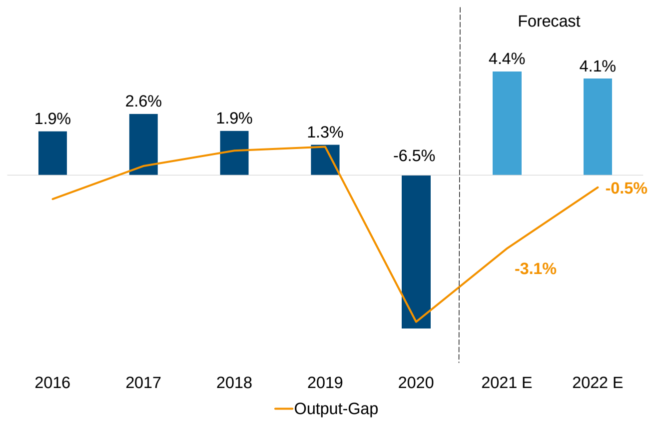
At present the euro zone economy is benefiting from significant steps toward reopening the services sector. These have been made possible by swiftly declining COVID-19 case numbers. This in turn is primarily due to rapid progress in vaccination coverage in all countries and positive seasonal effects on account of warm summer weather. Sentiment indicators and mobility data point to dynamic growth in 2Q after the slight decline in GDP in 1Q. Since we do not expect any further significant restrictions to be imposed as from 3Q, the momentum of growth should be maintained this quarter. However, the focus of the recovery will shift from manufacturing to the services sector in the euro zone as well. This shift should contribute to a general easing of bottlenecks in global supply chains.

EU recovery plan with positive impact in the 2nd half of the year

On the component level, mainly consumer spending should benefit from the reopening of the services sector. In the 2nd half of the year, the euro zone economy should additionally benefit from the distribution of the first funds from the EU recovery facility. Relative to their economic output, particularly countries such as Greece, Portugal, Spain and Italy will benefit quite significantly from these grants. The targeted use of the funds in sustainable public investment projects should also boost the longer-term growth prospects of these countries. In our opinion this will improve the economic and political stability of the euro zone.

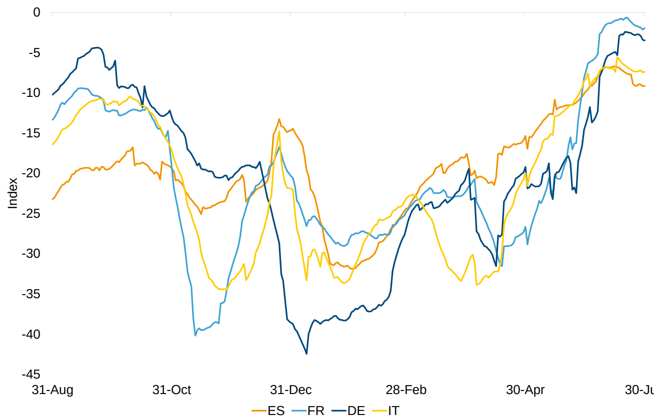
Despite expecting strong GDP growth rates of 4.4% for 2021 and 4.1% for 2022, we believe the euro zone economy will not approach its potential until the end of 2022 at the earliest. Hence the under-utilization of resources in the economy will remain substantial, and we therefore do not expect sustained upward pressure on wages and prices before 2023.

Substantial resource under-utilization remains
GDP growth vs. output gap



Source: Eurostat, Erste Group Research

Mobility is normalizing
Google mobility data (14-day average)



Source: Google, Erste Group Research

EU Recovery Plan

Greece, Portugal, Spain and Italy the main beneficiaries

The objective is to increase productivity

The EU recovery and resilience facility (also known as "NextGenerationEU") with a volume of EUR 750bn represents a historic opportunity to fortify the economic foundations of Southern Europe. At its core the recovery plan is designed to achieve a sustainable increase in labor productivity, the crucial factor ensuring long-term growth of economic welfare. A major driver of labor productivity is the quality of an economy's capital stock. Ever since the financial crisis the capital stock of southern Europe has deteriorated, as public investment was neglected. However, through targeted investments in highly productive areas (including digitalization and education) there is now a high probability that thanks to a strengthened capital stock, labor productivity in Southern Europe will be growing in coming years.

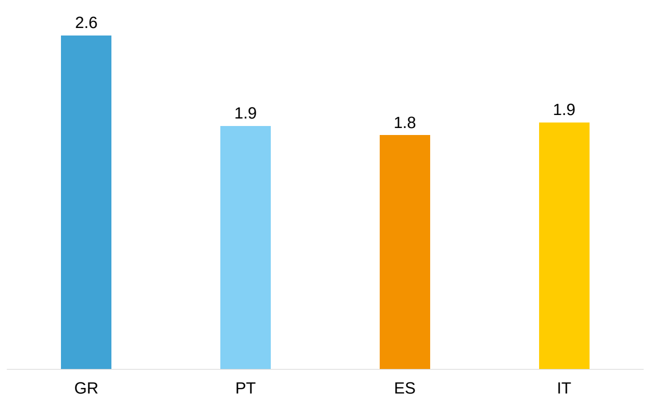
Structural reforms as a quid pro quo

Furthermore, long overdue structural reforms (inter alia strengthening of competition and administration) have to be implemented in return for the funds. These reforms will reinforce the positive effects of investment on labor productivity. Moreover, competition reforms raise the probability that foreign private investment will increasingly flow into Southern Europe, which should strengthen the capital stock further.

Improvement of debt sustainability

From the perspective of financial markets, raising productivity in Southern Europe is important because it will boost potential growth, which will make sustainable higher growth rates possible in the long term. This will improve debt sustainability, as higher growth rates will enable faster declines in government debt ratios. This is of fundamental importance in light of the public debt ratios of euro zone member countries having increased to historic highs due to the pandemic. The financial resources of the recovery facility should immediately boost average GDP growth in Italy or Spain by close to 2% p.a. from 2021 to 2027. As a result of this dynamic growth, public debt ratios in these countries should already decline sustainably in the near future.

Significantly stronger growth expected
Additional GDP growth p.a. 2021 - 2027



Source: European Commission, Erste Group Research

Self-reinforcing process
Effects of reforms and investments

Source: Erste Group Research

Euro Zone Inflation

Focus on commodity prices in the short term - labor market decisive in the long term

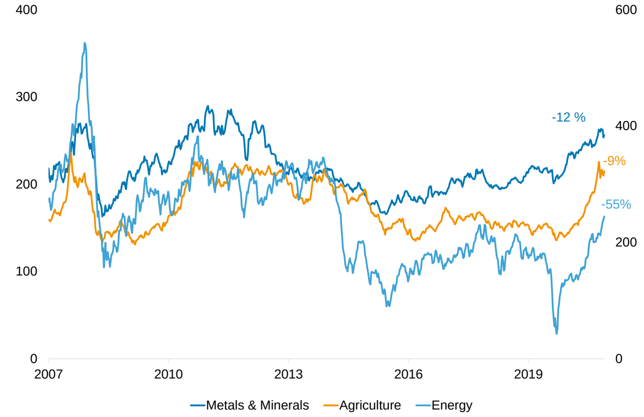
Headline inflation in the euro zone rose markedly toward 2.0% in the 1st half of the year. This was primarily caused by base effects from energy prices, which led to strong transitory upward pressure on headline inflation. Generally the situation in global commodity markets has come to the fore due to significant price increases. However, despite the recent advance, the most important commodity classes still trade below their historic highs, which in some cases date back more than 10 years.

Energy transition drives price increases in metals

In our view, several factors - such as the rapid and strong recovery of the global manufacturing sector - have contributed to the substantial price increases in a number of commodity classes. In addition, demand for industrial metals has grown strongly due to their essential importance for renewable energy and e-mobility, as the future build-out of the necessary infrastructure has received considerable political backing since the end of 2020. Against this background, additional increases in the prices of industrial metals are conceivable in the long term.

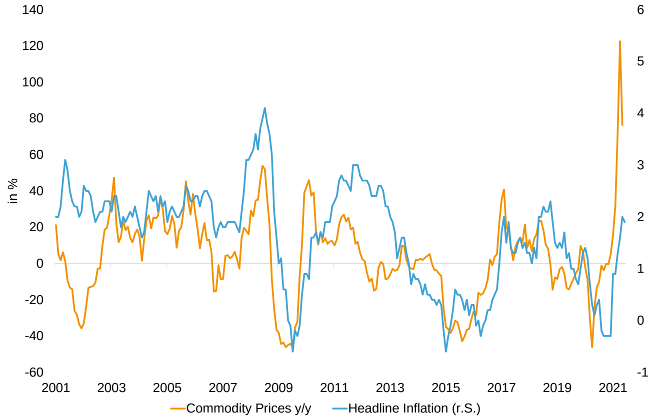
The weather phenomenon "La Nina" played a decisive role as a driver of agricultural commodity prices in the 1st half of the year. This is a temporary cooling of the Pacific Ocean which has a negative impact on weather conditions in the world's most important growing regions for agricultural commodities. It dampens the outlook for harvest yields in both the northern and southern hemispheres, which caused the market to respond with price increases. However, temperatures in the Pacific have returned to normal as of April, which should stabilize the weather, particularly in the southern hemisphere. This should improve the outlook for harvest yields. Prices of agricultural commodities have already lost a little ground since the beginning of May.

Not yet at new highs
Commodity price indexes



Source: Bank of Canada, Erste Group Research

Tight correlation evident
Commodity price index y/y vs. EZ headline inflation



Source: Bank of Canda, Eurostat, Erste Group Research

Commodity prices affect headline inflation temporarily

Historically, price fluctuations in global commodity markets have had a substantial direct impact on industrial producer prices and headline inflation in the euro zone - but these effects have always been temporary. Significant increases in both aggregates were therefore evident in the 1st half of the year. However, as the momentum of the rally in global commodity prices is already weakening since May, we expect that at least producer prices will experience a similar decrease in momentum in the second half of the year. Headline inflation should nevertheless stabilize slightly above 2%.

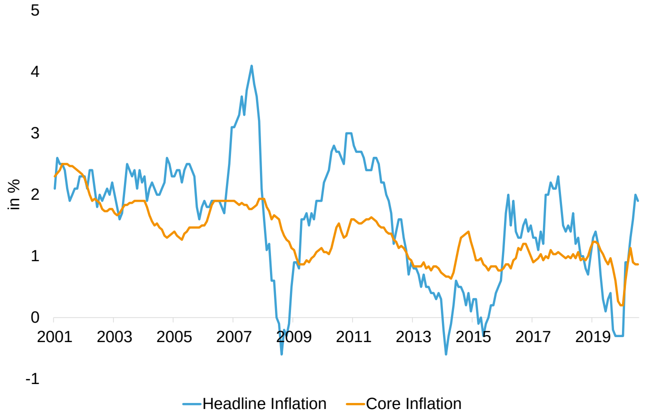
For the monetary policy stance of the ECB, inflation adjusted for energy and food prices (core inflation) plays a decisive role. In this context, historical data show that there has been barely any correlation between the trends in headline and core inflation. In the last cyclical upswing from 2017 to 2018 core inflation remained stable, fluctuating in a tight range of 0.9% to 1.2%, despite a temporary increase in headline inflation.

Labor market determines sustainable inflation outlook

In the short term, we expect upward pressure on core inflation in the 2nd half of the year. However, this is due to temporary effects attributable to the pandemic (inter alia tax-related effects in Germany). With regard to the medium-term outlook for core inflation, wage growth is important - which in turn is determined by labor market conditions. Taking into account people on short-time work, the unemployment rate in the euro zone would probably be between 13% and 16% as of May. This means that contrary to what the official unemployment data suggest, there is currently a considerable oversupply of labor in the euro zone. We therefore expect that a significant oversupply of labor will probably persist at least until the end of 2022. The substantial under-utilization of the labor market and the associated lack of upside pressure on wages will also dampen general price pressures and thus continue to facilitate an expansionary monetary policy stance by the ECB.

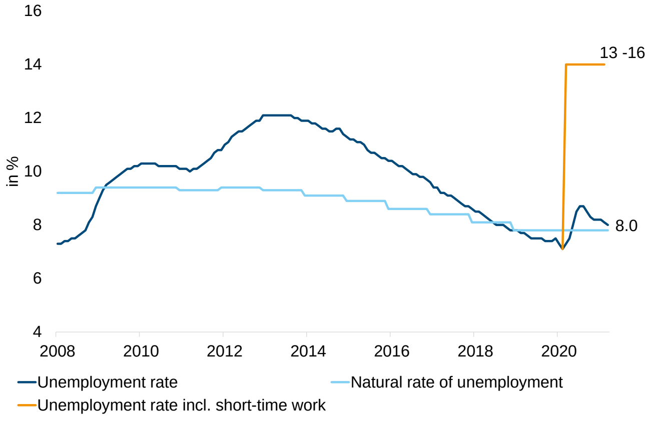
In view of the momentum in global commodity markets, we expect a significant increase in headline inflation to 1.8% in 2021. However, in light of the fading of base effects from energy prices, we are forecasting a decline to 1.4% already as early as 2022.

Low correlation
EZ headline inflation vs. core inflation (2000 – 2021)



Source: Eurostat, Erste Group Research

Short-time work distorts labor market data
EZ unemployment rate vs. unemployment rate incl. people on short-time work



Source: European Commission, Eurostat, Erste Group Research

Germany

Focus on federal elections at the end of September

GDP 2021: +3.4% y/y

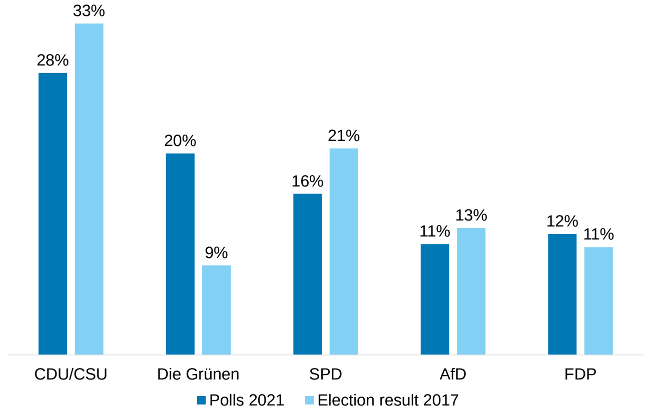
Germany's economy contracted by 1.8% in the 1st quarter due to strict containment measures. Especially consumer spending weighed on growth, while investment spending supported growth. Starting in the 2nd quarter we expect a strong recovery in line with significant steps toward reopening the economy, which should primarily be driven by consumer spending.

For 2021 as a whole, we expect GDP growth of 3.4%, followed by further growth of 4.0% in 2022. Germany's growth rates should gradually approach potential growth of around 1.3% from 2023. In keeping with its significantly above-average level of prosperity, Germany will receive grants totaling just 0.8% of GDP from the EU recovery facility until 2027. Germany plans to use the grants almost exclusively for the digital and green transformation. A strengthened Green Party after the Bundestag elections could lead to higher fiscal deficits in the medium term and thus higher growth rates. However, this will depend on whether or not the Green Party will join a government coalition after the election.

Political change lies ahead

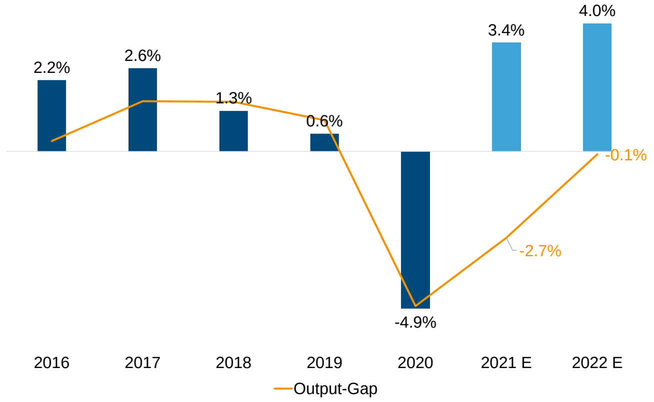
From a political perspective Germany faces substantial change in 2021. Long-time Chancellor Angela Merkel will leave office on occasion of the parliamentary elections on 26 September 2021. According to recent polls, the CDU/CSU alliance is in a neck-and-neck race with Alliance 90/The Greens. Should the polls remain essentially unchanged until the end of September, Germany's Green Party will gain considerable political influence thanks to gains in Bundestag seats. The Green Party's platform with its focus on environmental protection, sustainability and greater social justice is aligned with the current zeitgeist. The question is to what extent the party will be able to take a stand against the powerful German industrial lobby and whether or not it will join the future government.

Strong gains expected for Green Party
Bundestag election results 2017 vs. polls 2021



Source: Politico, Erste Group Research

Output gap should already close by 2022
GER GDP growth vs. output gap



Source: European Commission, Eurostat, Erste Group Research

France

Presidential election campaign will dominate the 2nd half of the year

GDP 2021: +5.3%

France's economy contracted only marginally by 0.1% in the 1st quarter. Consumer and investment spending both recorded small increases, while foreign trade weighed on growth. As from the 2nd quarter we are forecasting strong growth momentum thanks to significant reopening steps.

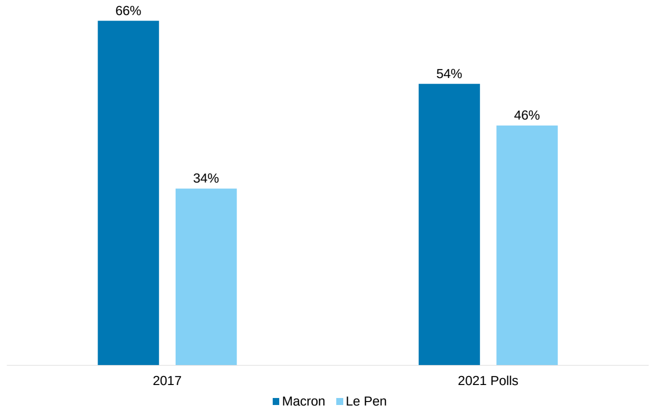
1% additional growth per year until 2026

For 2021 as a whole, we expect France's GDP to grow by 5.3%, followed by +3.7% in 2022. In both 2021 and 2022, French GDP growth will benefit from substantial fiscal stimulus measures (8.5% of GDP and 4.5% of GDP, respectively). In coming years France's government will support the economy with a comprehensive stimulus plan totaling EUR 100bn (EUR 40bn thereof from the EU recovery facility), complemented by smart reform projects and tax cuts. This will provide the French economy with an annual growth boost of close to 1% of GDP until 2026. Our analysis suggests that the measures should subsequently have a positive effect on France's growth potential as well, as they will raise productivity.

Macron vs. Le Pen

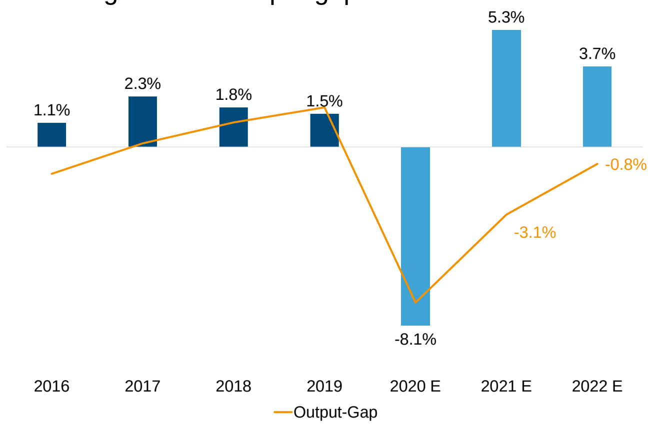
Emmanuel Macron has to stand for re-election as president in April 2022. The 2nd half of the year will therefore already be strongly dominated by the election campaign. Based on recent polls, Macron and Marine Le Pen will be facing off in a run-off election as they did in 2017. In the wake of her defeat in 2017, Le Pen has changed course with respect to core issues of her party's agenda. On the one hand, she has deviated from her strongly EU-critical stance and distanced herself from demanding a return to the French franc and an exit from the EU. On the other hand, environmental protection has been increasingly integrated in her election program. A change of direction, which - together with the renaming of the party to "Rassemblement National" (RN for short) – is intended to position the party closer to the moderate conservative camp. However, Le Pen's party recently performed disappointingly in regional elections. The right-of-center Conservative Party was the big winner in these elections.

Close result predicted
Presidential election 2017 vs. polls 2021



Source: Harris Interacitve, Erste Group Research

Rapid recovery should be possible
FR GDP growth vs. output gap



Source: European Commission, Eurostat, Erste Group Research

Italy

EU recovery plan will boost GDP growth markedly in the medium term

GDP 2021: +4.2% y/y

Italy's economy recorded slight growth of 0.1% q/q in Q1 2021. In particular, strong growth in investment spending (+3.7% q/q) compensated for a moderate decline in consumer spending and a negative trade balance. As from the 2nd quarter, we are forecasting strong growth momentum thanks to significant reopening steps and expect GDP growth of 4.2% for the full year.

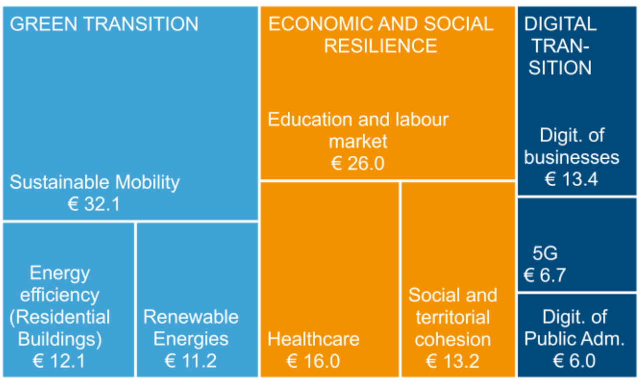
Recovery plan focusing on Italy's south

Italy's government plans to draw down the financial resources of the EU recovery facility in full in coming years (grants and loans totaling EUR 192bn). Thanks to this funding, we are forecasting above-average GDP growth of 4.6% for 2022. Theoretically, Italy could increase its GDP growth by almost 2 percentage points per year until 2027 if the EU funds are drawn down in full. Given the historical wealth gap, Italy is focusing its planned investments on the south of the country. With a view toward green transformation, renovation of buildings is to be promoted and new waste incineration plants are to be constructed. To strengthen sustainable mobility, high-speed train connections and the rehabilitation of port facilities are planned. As part of the digitalization strategy, the expansion of the 5G network is to be accelerated. The education sector can also look forward to substantial investment. The expansion of childcare facilities is intended to integrate more women into the labor market.

Supervision by EU Task Force on Recovery and Resilience

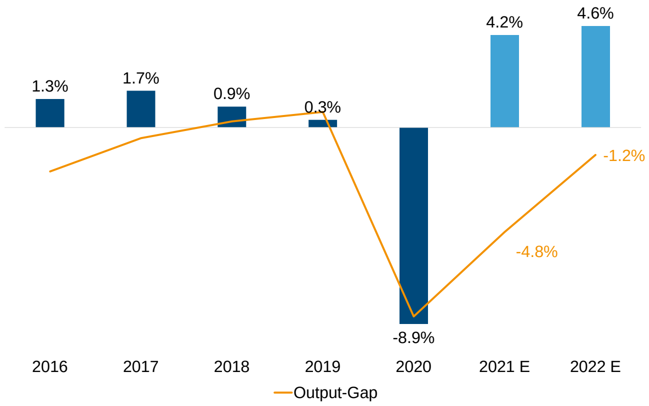
The largest risk factor looming over the growth outlook is whether Italy's administration will be able to manage allocating and monitoring these considerable financial resources. For this reason, the reforms are inter alia focused on public administration, which is to become significantly more efficient through investments in digitalization and management capabilities. In addition, far-reaching reforms of the tax system (reduction of complexity) and the judiciary are planned. Naturally the process is also going to be monitored and accompanied by the EU via the Task Force for Recovery and Resilience.

Focus on sustainable mobility and education
Planned expenditures EU recovery plan in EUR bn



Source: European Commission, Erste Group Research

GDP growth of 4.2% expected
IT GDP growth vs. output gap



Source: European Commission, Eurostat, Erste Group Research

Spain

EU recovery plan should provide lasting boost to growth

GDP 2021: +5.7% y/y

Spain's economy contracted by 0.3% q/q in 1Q 2021. Investment spending in particular weighed on growth. As from 2Q, we are forecasting a strong recovery of Spain's economy, which should generate GDP growth of 5.7% in 2021.

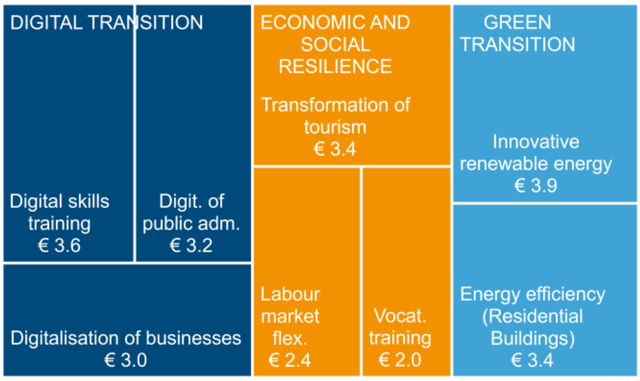
Spain initially only applying for grants

For the time being Spain has only requested approval for grants from the recovery facility (EUR 69.5bn). Madrid intends to apply for subsidized loans (EUR 71bn) only after 2023, if necessary. Based on the expected grant funds, we are forecasting above-average GDP growth of 5.8% in 2022. If Spain were to fully utilize the funds of the recovery facility, the level of GDP growth would be raised by slightly more than 2 percentage points per year until 2026. In total, Spain plans to implement 110 projects in the areas suggested by the Commission - some of which are to exploit synergies in cooperation with Portugal: these include the expansion of hydrogen and battery production, the extension of the 5G network and an expansion of rail transportation and green mobility.

Reforms crucial for long-term success

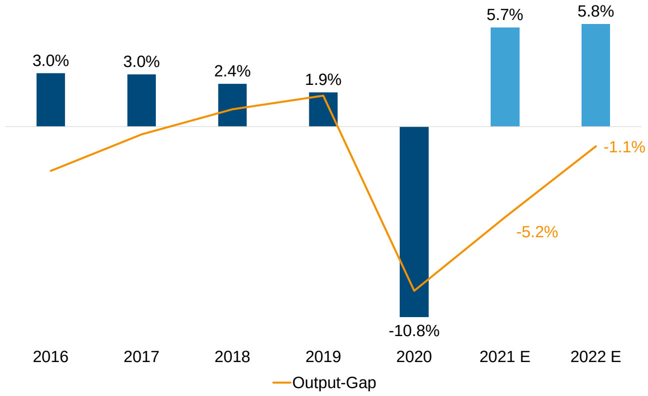
However, the implementation of reforms will be much more important for the long-term economic success of the recovery plan. For example, Spain will reduce the high proportion of workers on temporary job contracts, as they exert a negative effect on labor productivity. Furthermore, regional differences in unemployment insurance will be eliminated, as they inhibit worker mobility. In addition, a retirement reform is planned in order to preserve the pension system in the long term: incentives for later retirement are to be set, early retirement is to be reduced and pension indexation revised. Without a doubt these reforms are unpopular, which is prompting justified skepticism about their actual adoption.

Focus on digitalization and tourism
Planned expenditures EU recovery plan in EUR bn



Source: European Commission, Erste Group Research

5.7% GDP growth expected
ES GDP growth vs. output gap



Source: European Commission, Eurostat, Erste Group Research

USA

Economic boom in the US

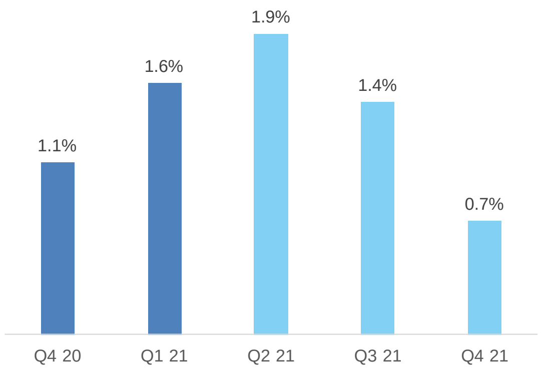
Economic expansion continues

As expected, strong economic growth was posted in the first quarter on the back of two economic stimulus programs. The second stimulus package, in combination with further steps to open up the economy, at a minimum suggests that economic growth will accelerate again in the second quarter. The outlook for the third quarter, which has just begun, is positive as well. The US economy is in a phase in which it is massively boosted by stimulus programs and steps toward reopening economic activity. While the associated effects could weaken somewhat, the third quarter is still expected to exhibit strong growth. However, from the perspective of market participants the decisive issue is not economic growth, but rather inflation.

Increase in inflation rates strong, but transitory

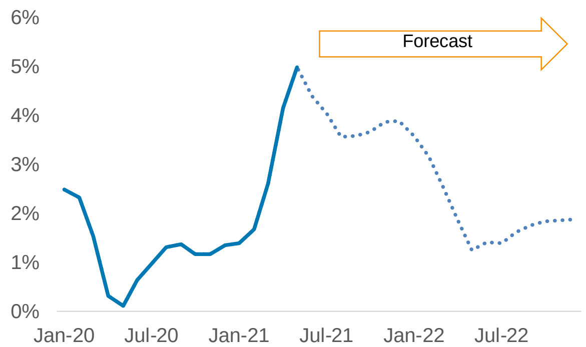
A significant rise in inflation rates in the spring was foreseeable for a long time, as price levels - particularly in the energy sector - had temporarily collapsed after the outbreak of the crisis in 2020. However, surprisingly the increase in inflation rates in April and May was fueled by enormous price increases in other product categories as well. Prices of used cars e.g. rose by more than 16% in these two months, airline tickets by almost 27%, and overnight accommodations by 7%. The fact that price increases were concentrated in relatively few areas which can be attributed to the ramp-up of the economy argues against a sustained strong upturn in prices. At the same time, the recovery phase in the US has not ended yet, so it is not clear what bottlenecks will remain for how long on the supply side, and how strong an increase in demand is yet to come. US consumers have accumulated a large amount of savings in the course of the crisis. For us, the most likely scenario remains that the surge in inflation rates in the course of this year will be transitory. The reason is that the supply side - after initial teething problems - should realign itself with demand again. With respect to demand, we do not expect any major catch-up effects, as this is unlikely in services, which represented the bulk of foregone consumption during the crisis. However, our estimates are subject to a great deal of uncertainty. This is because there is no experience with such a strong upturn in an economy that is already operating close to its potential.

Peak in economic growth in the 2nd quarter
Real GDP growth, q/q in %



Source: Bureau of Economic Analysis, Erste Group Research

Base effects and opening up of economy trigger massive surge in inflation
Inflation y/y in %



Source: Bureau of Economic Analysis, Erste Group Research

Emerging Markets

Global risk appetite underpins economic outlook

Sizable differences in pace of vaccination programs

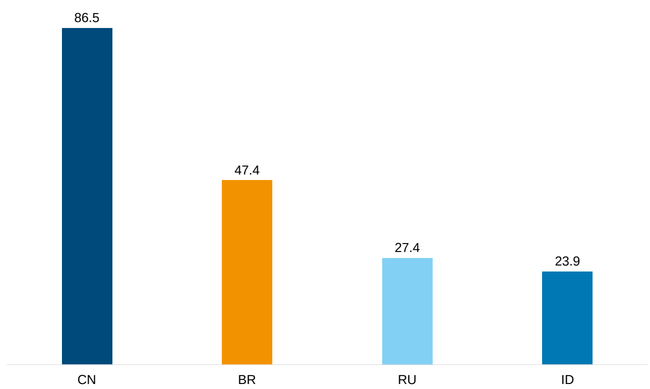
The situation in emerging markets is mixed. Due to vaccine shortages, local outbreaks of COVID-19 are likely to continue until 2022, which means that local restriction measures may occasionally continue to dampen growth for some time to come. Vaccine availability varies. While in China and Brazil more than 80 and 45 doses of the vaccine per 100 inhabitants have already been administered by the end of June, countries such as Russia and India are lagging noticeably behind. Thus the recovery will not progress at a uniform rate in all countries.

Expansionary US monetary policy facilitates capital inflows

Despite local COVID-19 outbreaks, emerging market economies have benefited several times in 2021 to date from the worldwide expansionary monetary policy bias of major central banks (particularly the Fed's). The expansionary policy has triggered an increase in risk appetite, which has encouraged growth-enhancing capital flows into emerging markets. This was reflected in a steady appreciation of emerging market currencies against the US dollar until the end in 1Q 2021. In addition, easy monetary policy reinforced the rally in global commodity prices. As commodities are important export goods for numerous emerging market countries, the increase in commodity prices in the 1st half of the year also boosted growth-enhancing capital inflows into these countries through rising export earnings.

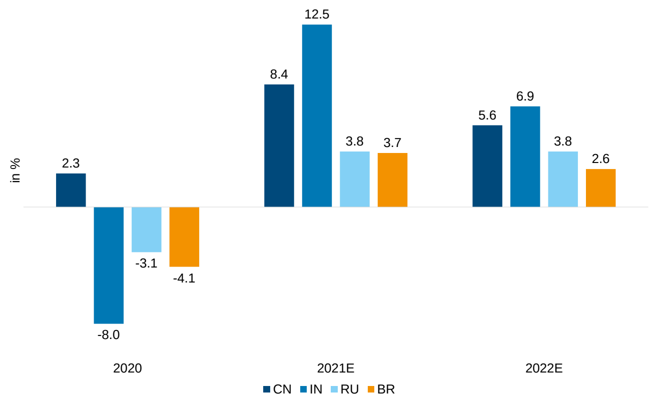
As a reflection of global capital flows, the development of emerging market currencies against the US dollar is basically a suitable economic barometer for these countries. Since the associated index - despite some volatility in the first half of the year – since the end of June once again indicates that emerging market currencies are strengthening against the USD, we expect support for emerging market economies from global financial markets to continue for the time being. However, the first half of 2021 has already demonstrated how sensitively this economic barometer can react to developments in US financial markets.

Fastest progress in China
COVID-19 vaccine doses administered / 100 inhabitants



Source: Our World in Data, Erste Group Research

Strongest growth expected in India
GDP growth CN, IN, BR and RU 2020 - 2022 E



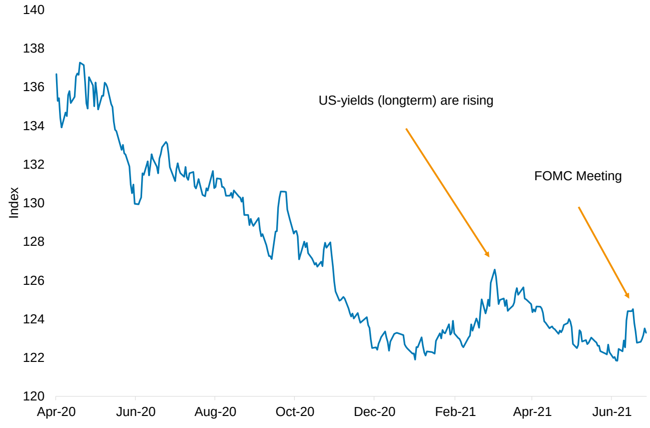
Source: IMF, Erste Group Research

US financial markets cause volatility

The sizable increase in US treasury yields at the long end in early March triggered a strong sell-off in emerging market currencies, as the increase boosted the level of real interest rates in the US. The sell-off in currencies led to short-term oriented capital being pulled out of emerging markets. Even though the situation subsequently calmed down again to some extent, FOMC meeting participants bringing expectations for US rate hikes forward in June triggered a renewed sell-off in emerging market currencies.

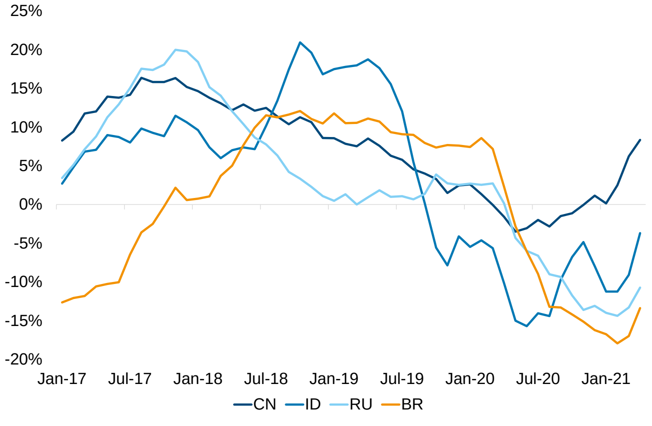
However, as long as no persistent downtrend in emerging market currencies against the US dollar becomes evident, we consider the economic outlook for these countries to be positive. In our opinion, the more concrete indications of a tightening of US monetary policy become (we expect the first rate hikes in 2023), the greater the risk that a persistent downtrend in emerging market currencies takes hold and that the economic outlook deteriorates. Currently the increasing momentum in the growth of German exports to emerging markets confirms our positive economic outlook.

Strong reaction to US financial market fluctuations
US-Dollar Index: Emerging Markets



Source: Federal Reserve Bank of St. Louis, Erste Group Research

Growing momentum in all countries
German export growth to CN, ID, RU and BR (12-month average y/y)



Source: Statistics Germany, Erste Group Research

China

German export data confirm China's economic expansion

High vaccination coverage

With a rigid approach aided by far-reaching use of electronic surveillance of its citizens, Beijing is keeping the prevalence of infection under control. Rapid progress in vaccination coverage with more than 80 vaccine doses per 100 inhabitants already administered, suggests that the recovery will continue. The IMF is forecasting GDP growth of 8.4% in 2021.

GDP growth should level off at 6%

In the 1st quarter, GDP growth momentum declined to +0.6% quarter-on-quarter. Previously China reported substantially above-average economic growth rates in the course of the catch-up process in the second half of 2020. We expect the pace of quarterly growth to level off close to the long-term average of approximately 1.5% in coming quarters. This corresponds to an annualized growth rate of around 6%.

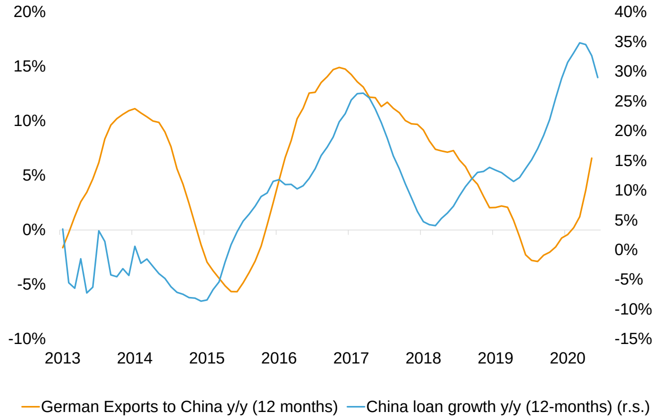
Central bank ready to support recovery

In the short term, a slowdown in credit growth indicates a moderate decrease in economic growth in coming months. According to the assessment of China's central bank (PBoC for short), the economy is already operating close to its potential growth rate again. Stable development of the economy is a top priority for the PBoC. It is therefore prepared to adapt its monetary policy at any time in order to achieve this objective. Should the decline in the momentum of credit growth dampen the pace of economic growth too strongly, we would expect an appropriate easing of monetary policy by the PBoC. However, the strong increase in German exports to China currently indicates that the cyclical expansion remains in full swing.

Focus shifts from quantity to quality

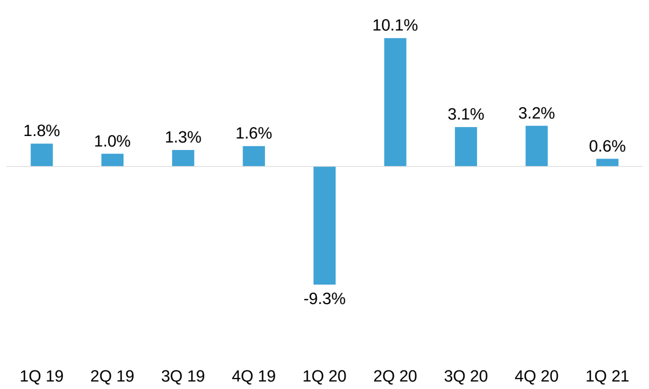
Over the medium term, China's economy is in a transition phase. In the future, the focus of economic growth is to shift from quantity to quality. For example, China wants the economy to be CO2-neutral by 2060. The aging population poses a challenge and the PBoC regards it as a factor that will dampen inflation in the future.

Lagged correlation
GER export growth to China vs. China credit growth (y/y)



Source: PBoC, Statistics Germany, Erste Group Research

In the short term slightly weaker in 1Q
China GDP growth quarter-on-quarter



Source: Statistics China, Erste Group Research

Forecasts [1]

GDP	2019	2020	2021	2022
Eurozone	1.3	-6.5	4.4	4.1
US	2.3	-3.5	6.1	3.3

Inflation	2019	2020	2021	2022
Eurozone	1.2	0.3	1.8	1.4
US	1.8	1.2	3.3	2.1

Source: Erste Group Research (own calculations)

[1] Note: In accordance with regulations, we are obliged to issue the following statement: Forecasts are not a reliable indicator of future performance.

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