Anno VI n°17 - May 2021

Macroeconomic and Commodities Outlook

Osservatorio energia
REF4E

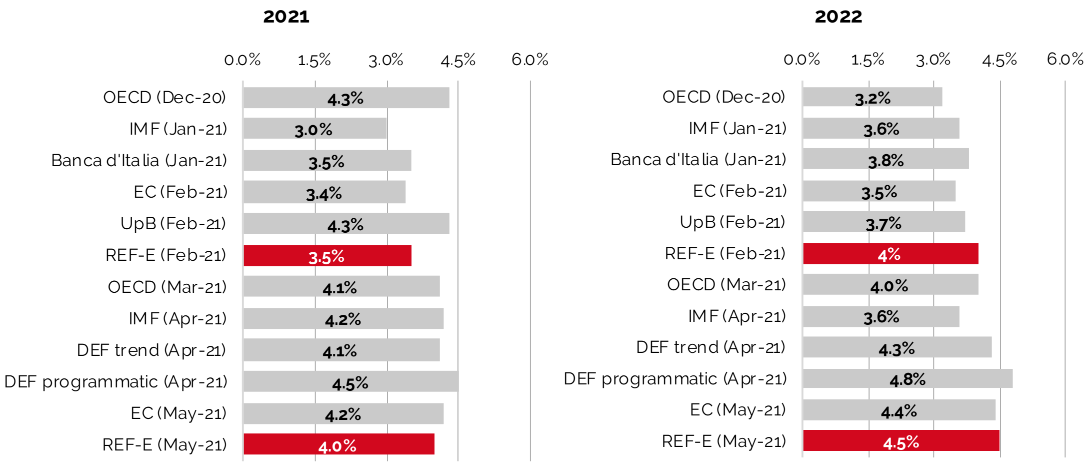
Forecasters' consensus converges on a short-term positive outlook, with **GDP expected to be back to pre-crises levels by year 2022**. A positive contribution of the industry sector supports this view. However, the effectiveness of stimulus measures is seen as the major determinant behind the new growth trend sustainability.

The commodities recovery is pushing prices higher. It is still uncertain whether this is only a temporary boost, or if it roots into structural shortages arising in production chains and in production factors' markets. Central Banks support the view of a short-lasting movement, while the concern of some experts for the tolerance of a high inflation level, in a period characterized expansive fiscal policies, is increasing.

Supply is still driving the oil market in the short-term, with the OPEC Plus leadership supporting the uptrend in force since last November. A progressive move towards a structural rebalancing of the market is still expected over the coming years though, with rising prices favouring a comeback of the OECD production and record levels of both crude and refined products stocks weighing.

ITALIAN MACROECONOMIC OUTLOOK: THE RESTRICTIVE MEASURES' RELIEF PAVE THE WAY TO A NEW ECONOMIC REBOUND

Starting from March 2021, economic growth and prices recovery prospects have been upwardly revised by consensus' economic forecasts. Data showing the enhanced ability of many production sectors to cope with COVID-19's second and third waves' restrictions and the success of vaccination campaigns supported the upward revision, together with the initial evidence, in some sectors, of demand and investments supportive measures positive effects. The new consensus forecasts point to the Italian GDP being back to its pre-crisis level by the second half of 2022, with the realignment of the Italian economic growth rate to other European countries for the first time after years.



Source: REF-E eleborations

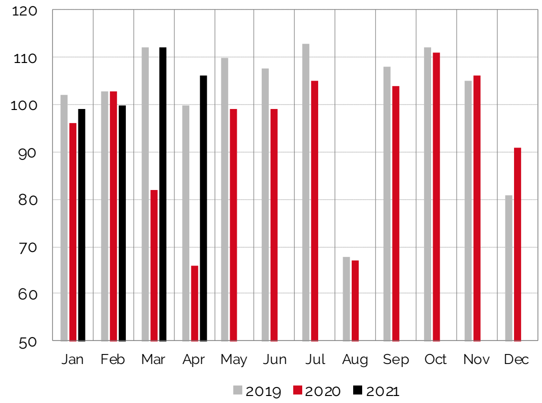
Variability on short-term GDP growth expectations is very low. This does not exclude the risk of a revisions though. The spread of new variants of the virus, the response of vaccination campaigns and the capability of advanced economies to address the needs of less developed countries represent the major uncertainty factors, but the evolution of consumers' willingness to save may affect short and medium-term recovery as well. A faster return to pre-pandemic consumption behaviours than generally assumed by short-term consensus forecasts will indeed speed up the rebound of economic activity, but a drop in the willingness to spend and an increased level of income inequality may instead reduce the recovery potential. A stronger than expected response by consumers to the restrictions' lifting may also add pressure on inflation, which is already supported by the commodities prices' up-moves and by the scarcity of input in the production sectors.

Medium and long-term growth perspectives are more uncertain than the short-term ones, with the effectiveness of stimulus measures being the major determinant behind the new growth trend. According to the Italian government, the Recovery and Resilience Plan (RRP)'s measures alone could contribute to a GDP increase by 3.6 percentage points in five years, would the more than 200 billion of European funds be effectively invested and the planned reforms implemented. A partial failure in these investments would lead to a lower additional increase in GDP by 2026 (+1.8%) and to a new fall in the pre-crisis state of economic stagnation.

January-May 2021: The Manufactory Resilience Supports GDP

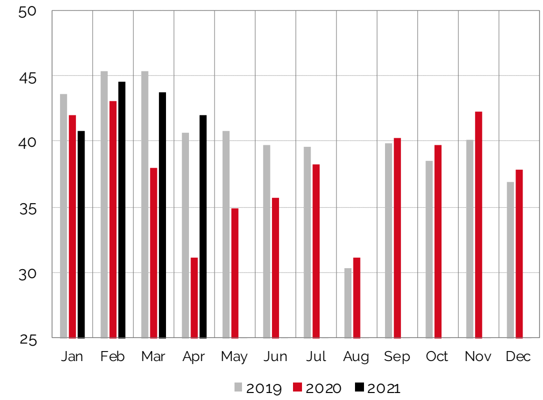
Despite still tight Covid-19's restrictions, the Italian GDP suffered a minor contraction over the first quarter of 2021 (-0.4% quarter-on-quarter, according to ISTAT's preliminary data). The fall was driven by the contact-intensive **service sector**, more strongly hit by restrictive measures, while higher frequency indicators suggest a positive contribution of the **industry sector**. Between January and March 2021, Electricity and gas consumption in the industry sector was indeed only slightly below pre-pandemic levels, the industrial production index (seasonally adjusted) remained above the Q4-2020's average value and the industry confidence index reached its maximum since the pandemic start. The absence of targeted restriction to industrial activity and the ongoing recovery of domestic and foreign demand, with the latter now realigned with pre-crisis levels, supported the resilience of the manufactory sector. The **construction sector** kept showing signals of recovery as well, supported by fiscal stimulus measures.

IMCEI index for electricity industrial consumption (no calendar adjustment)



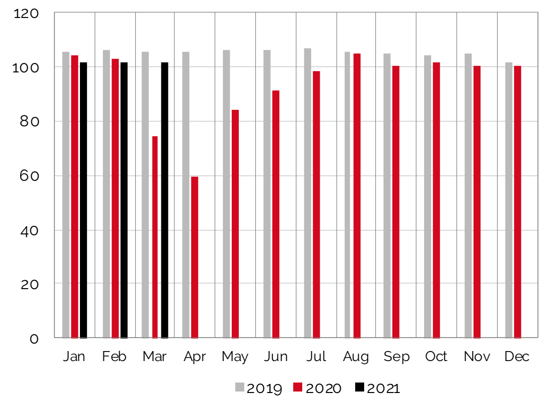
Source: Terna

Gas average daily industrial consumption (Mmc - weekdays only)



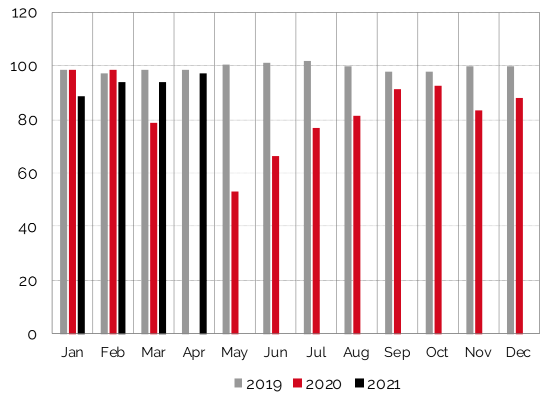
Source: SRG data processing

Italian industrial production index (seasonally adjusted)



Source: ISTAT

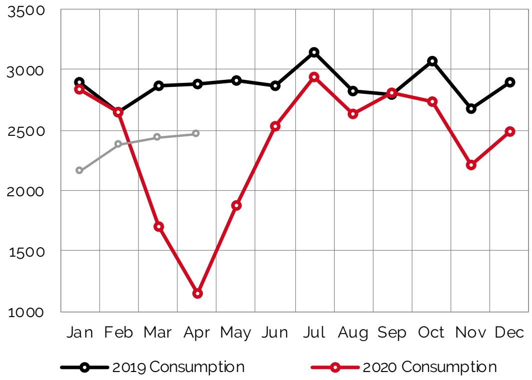
Industry confidence index (seasonally adjusted)



Source: ISTAT

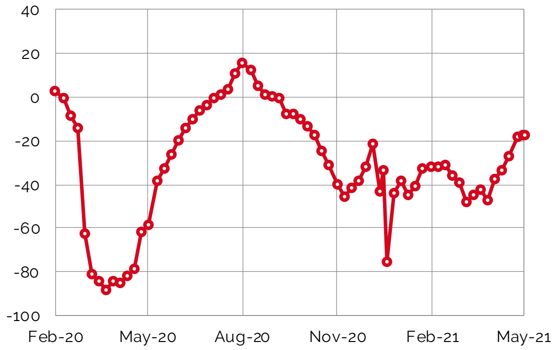
Fuels' consumption in the **transportation sector** remained over 10% below 2019 levels until April 2021, confirming the heterogeneity of the recovery trend across sectors. More recent data from Google trends shows an increase in movements towards retail and recreation venues, consistently with the gradual softening of limitations over the past weeks. This provides a preliminary indication of an initial rebound for the service and transportation sectors that will contribute to Q2 recovery.

Consumption of Fuels* for Transportation (000/ton)
*Gasoline, Diesel and LP Gas



Source: MiSE

Movements towards Retail and Recreation Venues (% variation compared to the period January 3rd-February 6th 2020)



Source: Google Trends data processing

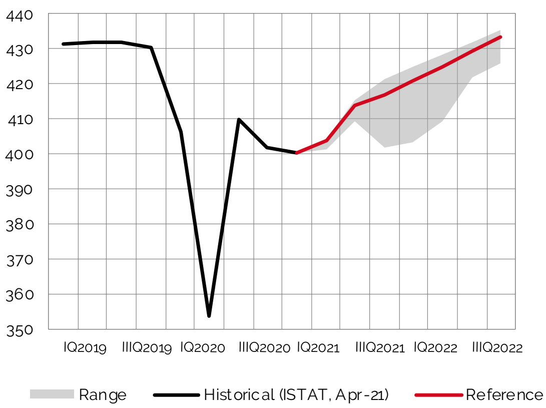
The **labor market** keeps showing limited changes. Between January and March 2021, the number of people employed fell by 1%, compared to the previous quarter, while the number of job seekers increased by 3%. March's data shows some positive signals for temporary workers, the positions most hardly by the pandemic effect (9% fall between January 2020 and March 2021), whose number increased by 63 thousand units compared to the previous two months. More recent data from the job platform adds evidence of a positive ongoing trend, showing an increase in the number of job openings in European countries. The labor market outlook remains uncertain, though, with retention schemes mitigating the impact of the pandemic on the labor market expiring in June 2021. Their removal may translate in an increase of job dismissals in the absence of new support interventions, that may weight on lower incomes and, as a result, on demand recovery.

2021-2022 Demand Outlook: vaccination campains accelerate the recovery

GDP forecasters revised the next two years projections higher, following the speeding up of vaccination campaigns, the restrictive measures softening and positive signals from the manufactory and construction sectors.

In a Reference scenario, GDP is expected to growth 4% in 2021 and 4.5% in 2021 (+0.5 percentage points compared to February update), leading the Italian GDP above 2019's levels in the second half of 2022.

Italian real GDP outlook (€B)



Source: ISTAT and REF-E forecats (May-2021)

The underlying assumptions are:

- vaccination campaigns leading to the overcoming of the pandemic over the next few months
- gradual lifting of restriction in Q2-2021 sustaining an initial recovery of GDP, that will strengthen in Q3-2021 and continue onward
- domestic demand, boosted by increasing spending opportunities, supports the economic rebound in the short term, despite the persisting risk for the contraction of lower-level

incomes and the accumulation of savings by higher incomes, with a lower propensity to spend, weighing on demand's potential contribution

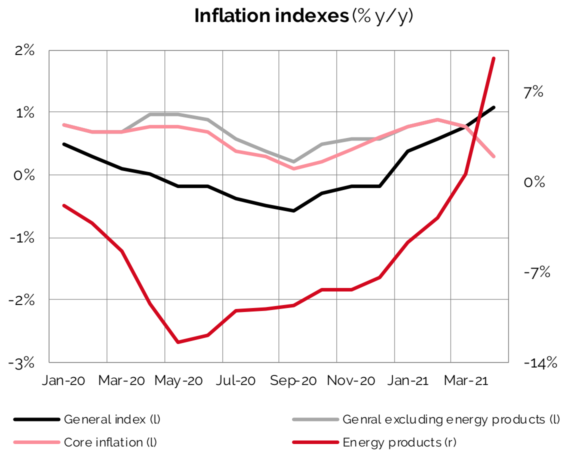
- private and business investments, sustained by the RRP and by public incentives schemes (such as the Superbonus 110%) should continue to support the recovery
- foreign demand for goods may benefit from positive export conditions, while foreign demand of services may instead remain subdued due to persisting limitations to movements and greater caution in people's travelling choices

In the event of a failure of the vaccination campaigns to respond to the virus variants, this would lead to a Low economic growth scenario, with GDP falling again in Q4-2021 for the reintroduction of restrictive measures. GDP increases by 2.6% in 2021 and by 3.0% in 2022

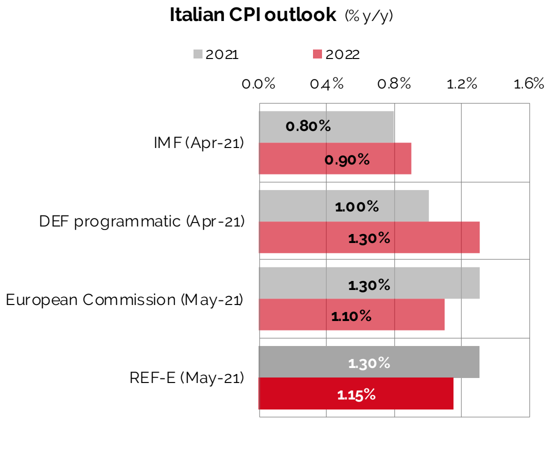
A more optimistic scenario, scenario High, assumes instead a greater effectiveness of the RRP's investments and reforms compared to a Reference scenario, with significant effects on GDP starting from the end of 2021, and a slightly stronger rebound of demand in Q2- and Q3-2021., GDP increase 4.5% and 4.8% in 2021 and 2022, respectively.

Inflation: Commodities' Recovery is Pushing Prices Higher

After having averaged -0.1% in 2020, starting from January 2021, the Consumer Price Index (CPI) settled again in positive territory, reaching a +1.1% year-on-year variation in April 2021, sustained by oil and raw material prices' strength. Energy products' prices contributed the most to the latter movement, with April's energy price index 9.4% above the previous year level. Core inflation, excluding food, tobacco, and energy products, rose near 1.0% during the first quarter, but moved again to a smaller year-on-year increase in April (+0.3%), reflecting a still low inflation pressure for services and industrial products, excluding energy ones, and the labor market's weakness.



Source: ISTAT



Source: REF-E eleborations

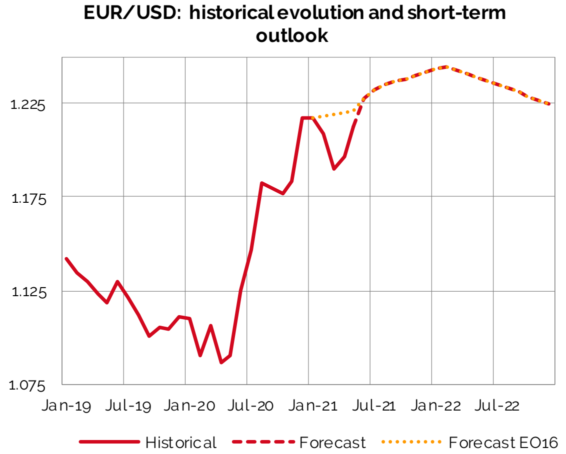
Over the past decades, despite recurrent concerns for cyclical increases of commodities prices, inflation dynamics in European countries remained generally below the ECB's 2% target. The current acceleration of prices growth follows the softening of Covid-19's related restrictions and the recovery from 2020's contraction. What remains uncertain is whether this increase is only the result of a temporary boost, or if it roots in structural shortages arising in production chains and in production factors' markets. While Central Banks support the view of a short-lasting movement, the concern of some experts for the tolerance of a high inflation level, in a period characterized expansive fiscal policies, is increasing.

The existence of scarcity issues in some sectors, due to low investments in the past years, is clear, and, after years of weak wages dynamics, it may be difficult to gather the necessary expertise to sustain investments, including the ones in the digital and green transition. This may translate into an increase of prices. Higher factors' productivity, combined with policies favoring a fair income distribution should limit the latter effect though. The space of intervention for government's policies is narrow, but a failure of the latter policies may not necessarily translate in the revival of speculation dynamics observed in the past.

Meanwhile, markets may account for the increasing time horizon covered by economic policies: for instance, the CO2 price's acceleration observed on the ETS market seems to reflect the increasing support for the achievement of European climate goals, creating conditions that anticipate the equilibrium price needed to sustain the gas to renewables switch. Whether this transformation will take place depends on the ability of governments to effectively invest in the training of the job titles required by the market for the transition.

THE EXCHANGE RATE: EMPLOYMENT PERSPECTIVES AND INFLATION EXPECTATIONS KEY TO CENTRAL BANKS DECISIONS

Short-term Inflation expectations are a key topic both in Europe and in the US, with the risk for the ECB and the FED being forced to reverse their very accommodative monetary policies too early seen as potentially impacting the two blocs relative growth paths and the exchange rate expected to reflect the latter dynamics.

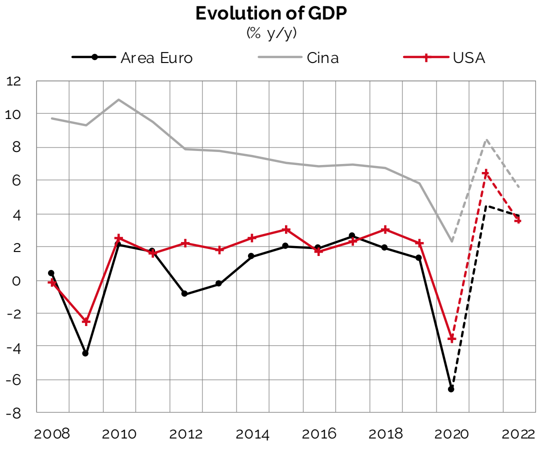


Source: REF-E elaborations on Reuters data

The combination of a higher inflation rate in the US compared to the Eurozone, converging GDP growth rates by year 2022 and accommodative stances by both the ECB and the FED point to the slow recovery path of the EUR-USD continuing in the short-term, in line with our previous forecast.

The exchange rate should average 1.22 this year and 1.24 in year 2022.

For the **US Federal Reserve**, tension between sticky job markets and rising prices could pose a growing problem, with an aggressive monetary policy having been put in place on the belief a conflict between returning US employment to pre-pandemic levels and keeping inflation under control can be avoided. US April data show slow job growth and faster-than-expected price increases though, while early employment data for May suggests hiring may have remained sluggish despite a record number of job postings. Low wages may be among the reasons the number of people working or looking for work remains about 3.6 million below the pre-pandemic peak of 164.5 million from late 2019. Weekly unemployment claims are falling, despite openings on job site being over 25% higher than the pre-pandemic baseline. Closed schools, unavailable day-care and early retirement are among the reasons hypnotised for the observed decrease of people in the labour market, with the temporary versus a structural nature of the latter decrease being still debated. Independently from the answer, full employment may be reached faster than expected and lead inflation above the 2.0% FED target both in year 2021 and 2022. The 28-Apr Federal Reserve statement opens on "using its full range of tools to support the U.S. economy in this challenging time" and, stressing both the ongoing public health crisis impact on the economy and risks to the economic outlook, aims to achieve inflation moderately above 2.0% for some time.

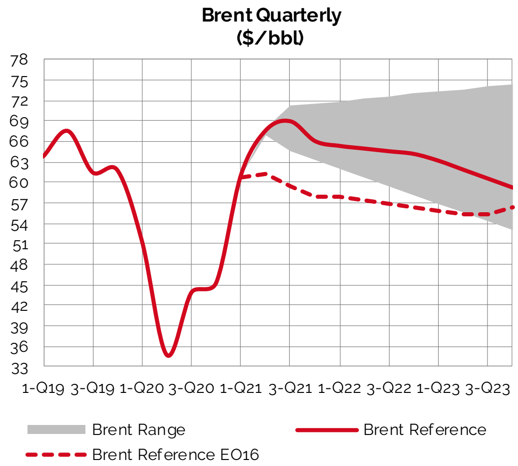


Source: IMF(Apr-21)

Signs that prices of goods and services are only headed higher from here are fuelling inflation concerns in **Europe** too, with a sharp global recovery in demand, driven predominantly by China, pushing up prices of metals, food, and fuels. As explained above, temporary shortages caused by the COVID-19 pandemic in industries such as semiconductors, steel and shipping are also threatening to fuel inflation. **Compared to the US, the European job market is restrained though**. Deutsche Bank expects the EU unemployment rate to average 8.5% in 2021 and 2022 and remain above the 7% pre-pandemic low for a few years, while economic policies being overall focused on jobs protection rather than pay increases point to a subdued Eurozone wage growth, which would weigh on demand for consumer goods and prices. The Eurozone. According to the OECD inflation should in fact remain well below the 2.0% threshold both in year 2021 and 2022.

SUPPLY STILL DRIVING OIL PRICES IN THE SHORT-TERM

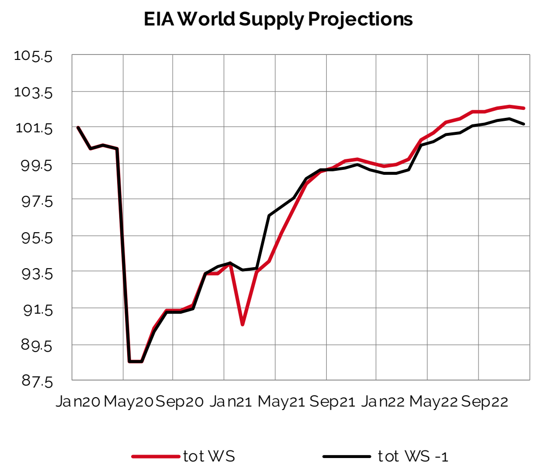
The OPEC Plus cooperation in supporting a rebalancing of the oil market still holds and the 27-Apr Ministerial OPEC and non-OPEC countries meeting decided on the continued implementation of the production 0.5 million barrel per day (mb/d) cut decision to be extended over the months of May, June, and July 2021, with market monitoring and a gradual adjustment expected to be implemented towards Sep-21. This, in combination with the significant additional voluntary supply adjustment of 1 mb/d made by Saudi Arabia in April-21, maintained the **oil market short-term supply driven, pushing prices higher than expected in the short-term.** A gradual return of the Saudis volumes in May, June and July 2021 is expected though, despite the prevailing uncertainties surrounding the pace of the oil demand recovery still looming. Moreover, Iran resuming oil exports once the US lifts trade sanctions would add volumes to the OPEC Plus overall supply risking to alter the so far very effective quotas management by the cartel.



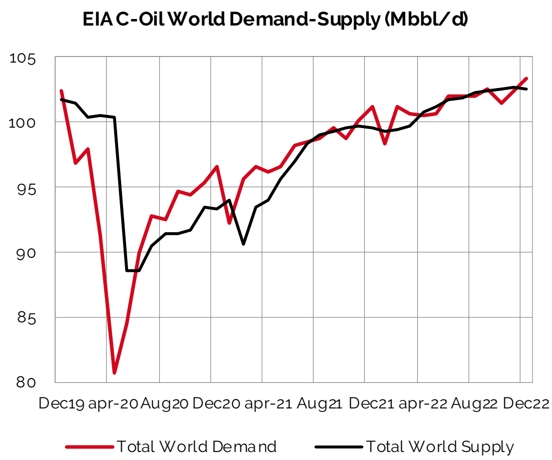
Source: REF-E elaborations

The *Reference* 2021 Brent average lies above 65 $/bbl. A 5 $/bbl upward revision compared to our previous update, follows OPEC Plus decision to maintain production curbs active longer than previously stated. Year 2022 settles just 1 $/bbl lower, with drilling activity in the US having slowed down and the OPEC Plus supplies possibly regaining a pivotal role in driving short-term price variations. The *Low* scenario materializes in the event of an OPEC Plus fracture and/or an economic recovery failure, while the *High* one is driven by both a quicker than expected demand recovery and a more incisive direction towards a green transition of the Democratic Administration in the United States, which may weigh on supply growth.

Compared to our previous update, the short-term supply projections were revised quite significantly lower. However, not only the Saudi production should progressively come back, but also, the OPEC Plus and the OECD one should resume beginning from Sep-21, which is likely to limit the upside potential towards the end of this year and in 2022. The OPEC most recent statement highlighted in fact the continuing recovery in the global economy, supported by unprecedented levels of monetary and fiscal support, noting that the recovery is expected to pick up speed in the second half of the year.



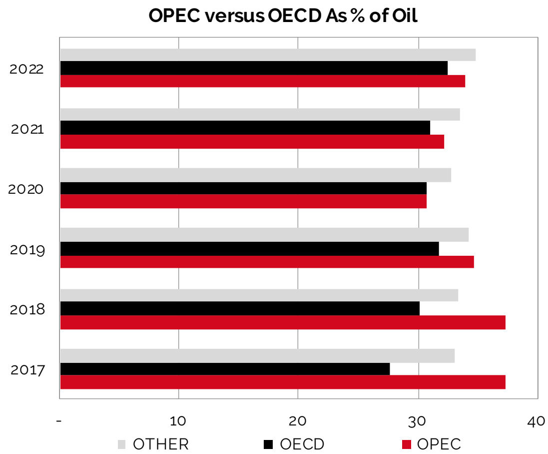
Source: REF-E elaborations on EIA data



Source: REF-E elaborations on EIA data

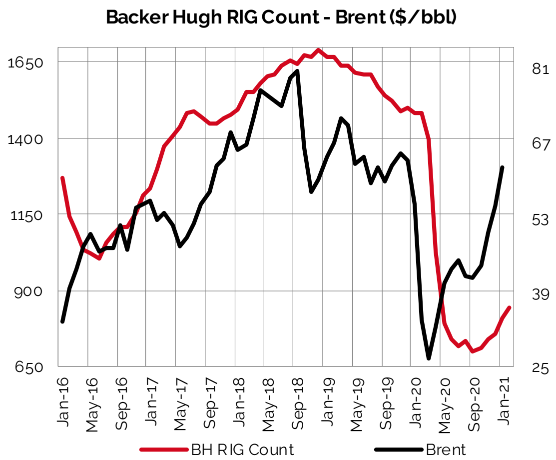
In a medium-term perspective, the OPEC Plus market intervention is still seen as not sustainable, with both Saudi Arabia and Russia facing fiscal issues encouraging production rump ups to gain market shares should prices move higher.

A progressive move towards a structural rebalancing of the market is therefore still expected over the coming years, with rising prices also favouring a comeback of the OECD production and record levels of both crude and refined products stocks weighing.

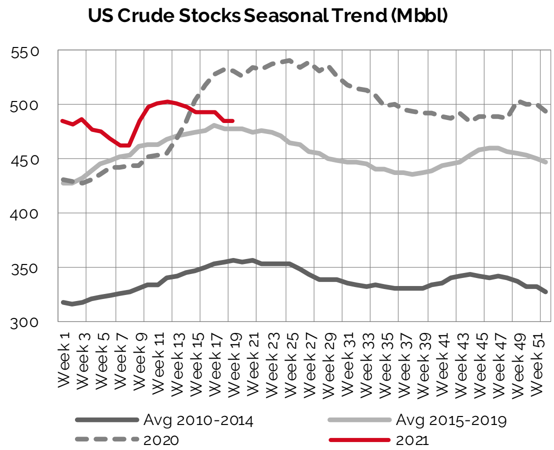


Source: REF-E elaborations on EIA data

A destocking trend of commercial OECD inventories is taking place, despite an increase by 14.4 mb in Mar-21 and the Q1-21 having closed 77.4 mb above the 2015-2019 average. The US crude stocks are decreasing too, but remain above the last five years average, which should contribute to limiting prices upside potential, while drilling activity for exploration looms. This may lead to a slowing growth path for the US supplies, putting the OPEC and, more reason, the OPEC Plus production in a dominant position. In this perspective and under the hypothesis of a progressive resumption of demand, a significant price decline is seen as unlikely in the medium-term.



Source: Reuters - REF-E elaborations

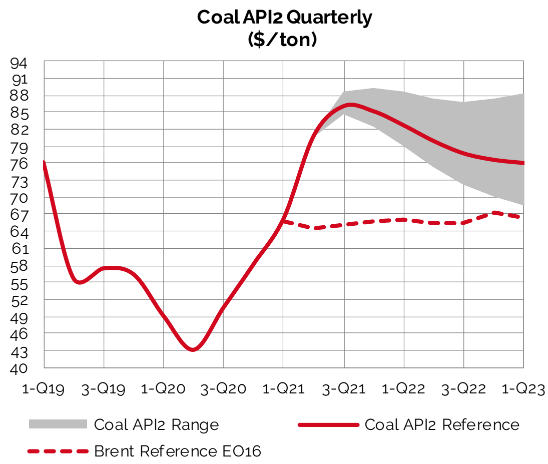


Source: EIA - REF-E elaborations

Biden leasing ban is temporary (BRENT COAL & CO2 OUTLOOK MAR 2021) and according to the Democratic administration oil companies still have plenty of undeveloped leases for which new permits continue to be issued. However, should a permanent ban on new leases be decided, this would mean drilling fading out as existing ones expire, with potential and, again, controversial impacts on the oil dependent regions and employment. Alternatively, Biden may increase royalty fees to reflect the climate change costs. That would make it more expensive to drill on federal land, forcing companies to concentrate on the most profitable reserves and reducing emissions, though by less than a ban. An ongoing consultation including representatives of industry, labour, conservationist groups, Indigenous people and others had been promoted by the Interior Secretary and an interim report should be completed this summer outlining recommendations for Interior and Congress to overhaul the fossil fuels program. This may bring more clarity on both the Democratic Administration concrete action on climate change and fossil fuels supply future dynamics.

SLOWING COAL DEMAND GROWTH TO WEIGH ON PRICES

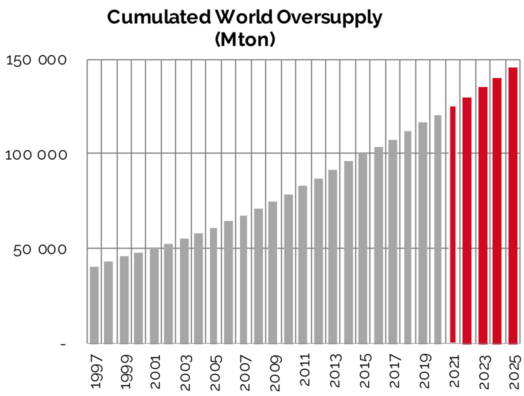
Coal demand was boosted by a colder and longer than average winter across much of north Asia and by the limited availability of spot cargoes of liquefied natural gas, which pushed prices sharply higher towards the reaching of our medium-term targets.



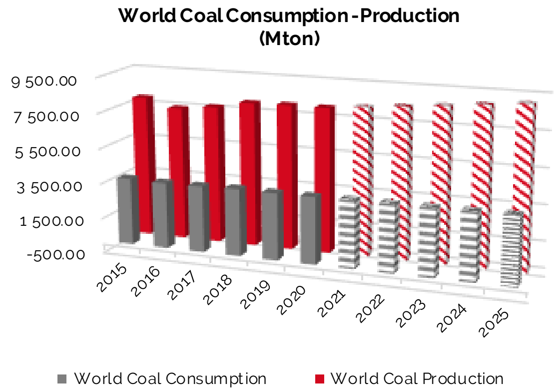
Source: REF-E Elaborations

The *Reference* 2021 API2 Coal recovery is revised higher to above 50% from the 50.3 $/ton 2020 average, following the last months extended up-move. Despite an upward revision having been made for the 2022 reference too compared to our previous forecast, the average settles near 75 $/ton, almost 5% below the 2021 one. The *Low* scenario materializes in the event of the economic recovery slowing down and/or the decarbonisation process accelerating, which would weigh on the commodities market overall. The *High* one is driven by a quicker than expected demand recovery and/or renewed commercial tensions, which may cause supply shortages.

World demand projections for the short-term point to an overall slow recovery, despite China and India significant contribution (together accounting for 65% of global coal demand). Despite the recent environmental protection policies supposedly restricting coal production in China and logistic costs for domestic coal higher than the imported one (mostly entering China by sea), **2.5% production growth is in fact expected in China in 2021**, supported by the commencement of projects including Dahaize and Xinjiang Zhundongs. In addition, India flagged coal as an essential commodity, reported 0.7% growth in 2020 and is expected to deliver 9% growth in output to reach 827.8 Mt in 2021.



Source: Data BP and Global Data: REF-E elaborations



Source: Data BP and Global Data: REF-E elaborations

In a longer-term perspective, with other coal producing countries also expanding their capacity, the Global coal production should grow at an annual rate of 2.3% between 2021 and 2025 to reach 8.8 billion tons in 2025. Meanwhile the supportive impact on demand by the economic recovery is counterbalanced and held back by the overall worldwide decarbonization process.

With green policies weighing and the world production growth gaining momentum, **the cumulated oversupply will keep piling up, limiting the possibilities for prices to move significantly higher than current references in the short-term and pointing to a slow decline in the medium-term.**

With the EU Parliament having approved the 2030 emissions reduction target at 55%, coal demand in Europe is expected to be progressively displaced by gas and renewables, which should limit the upside potential for the API2 European reference price. However, since the API2 has so far remained correlated to the other references (such as the Australian, strongly correlated to the Chinese, and the South African API4), in our *Reference* scenario the possibility for prices to move significantly lower in the short-term is limited too.

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