Global and European setting

Global economic developments

Subdued start to year for global economy

The pandemic maintained a firm grip on the global economy in the first quarter of 2021 as well. In many places, new waves of infections and tighter containment measures set the recovery back. Services were once again particularly affected. Towards the end of the reporting period, supply shortages were a drag on industry, which had initially experienced a lively expansion. This also drove industrial producer prices up. On the whole, the global economy continued its recovery in the first quarter, yet at a distinctly reduced pace. In the euro area, gross domestic product (GDP) was even down by 0.6% from an already weak preceding quarter. Japan likewise recorded a marked drop in activity, as did the United Kingdom: in spite of the rapid progress with its vaccination campaign, infection counts were initially high, to which it responded by resorting to strict containment measures which were eased only in the last few weeks. By contrast, the economic recovery took off again in the United States, where many restrictions were already lifted over the course of the first quarter and extensive stimulus packages gave the economy an additional boost. In China, where the pandemic has already been under control for quite some time now, the economy continued to recover, whereas some other emerging market economies suffered from the economic fallout caused by new waves of infections.

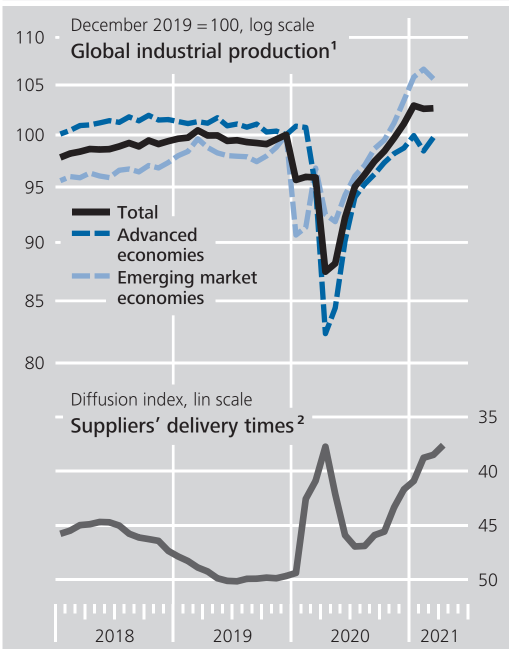
Supply-side constraints a drag on global industrial upturn

On a global scale, the industrial sector continued to benefit considerably from the pandemic-induced shifts in demand. Since its drastic slump in the spring of last year, global industrial production had grown substantially, surpassing its pre-crisis level in December 2020. The recovery went particularly quickly in the Asian emerging market economies. Industrial production in China has even risen far above its old growth path. However, in the advanced economies as well, production at the close of the first quarter was only slightly below its end-2019 pre-crisis level. At last report, however, the upturn in manufacturing was running into supply-side bottlenecks. Purchasing managers the world over reported rising delivery times. Similar complaints were already being voiced in April 2020, when delays in deliveries of spare parts were attributable to containment measures and disruptions in international supply chains. This time, the reason seems to lie in the exceptionally high demand for specific intermediate inputs such as, for instance, industrial commodities and semiconductors. Capacity constraints in maritime transport, which are also reflected in soaring freight rates, contributed to further delays.

On the back of strong demand for industrial goods, commodity prices picked up strongly

Indicators of global industrial activity

Seasonally adjusted



Sources: CPB, IHS Markit, national data, Haver Analytics and Bundesbank calculations. **1** Bundesbank extrapolation of CPB data at the current end. **2** According to the global Purchasing Managers' Index for manufacturing. Inverted scale; values below 50 indicate longer delivery times compared with the previous period.

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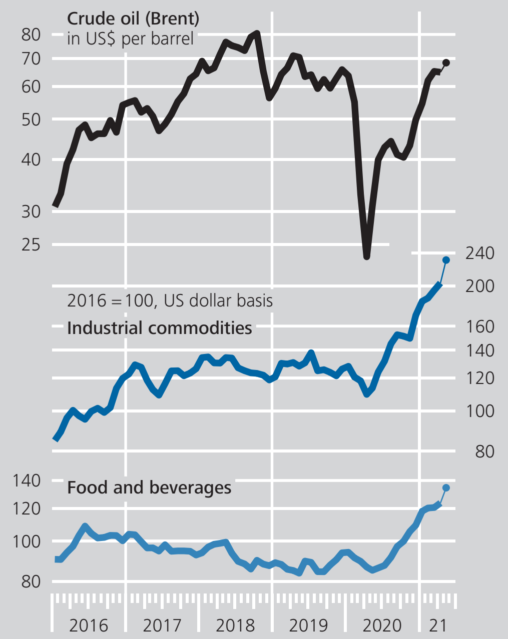
World market prices for crude oil, industrial commodities and food and beverages

Monthly averages, log scale



Sources: Bloomberg Finance L.P., HWWI and Bundesbank calculations. • Latest figures: average of 1 to 14 May 2021, or 1 to 18 May 2021 for crude oil.

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Commodity prices up strongly following pandemic-induced slump

following their pandemic-induced slump in the second quarter of 2020. On average, industrial commodities even cost around 80% more than prior to the outbreak of the pandemic. As this report went to press, oil prices, at US$68 per barrel of Brent crude oil, were roughly at the same level as prior to the crisis. In the last weeks of the reporting period, however, crude oil prices rose only slightly, as price-supporting and price-dampening factors broadly balanced each other out. Temporary production losses in some oil-producing countries and the brief blockage of the Suez Canal created upward price pressures. At the same time, the resurgence of the pandemic in some regions of the world curbed demand for crude oil, which dampened an upsurge of prices somewhat. However, vaccination progress caused the medium-term outlook for global oil demand to continue to brighten. Against this background, OPEC and its partners jointly decided to expand production moderately beginning in May 2021.

Signs of growing upward pressure on prices

The broadly based increase in commodity prices and the steep rise in transport costs manifested themselves in industrial producer prices, too, towards the end of the reporting period. The prices of intermediate products, in particular, rose considerably. It stands to reason that the cost surge will also have an impact on producer prices for final goods and then, further downstream, on the final consumption stage. In the industrial countries as a group, the annual growth rate of consumer prices already strengthened significantly from 0.7% in December 2020 to 2% in March. Base effects in energy prices have been one of the main reasons for this to date. However, over the same period, even core inflation, which strips out energy and food, picked up by 0.3 percentage point to 1.4%. Consumer price inflation is likely to have continued to accelerate in April. The exceptional degree of fiscal expansion in some regions and the, in most cases, highly accommodative stance of monetary policy are likely to keep price pressures pointing upwards over the longer term, too. However, once the current supply bottlenecks have been overcome, more moderate inflation rates are expected to ensue.

Continued path of global recovery depends on vaccination progress

How fast the global economy, especially services, continues to recover will depend in key measure on the trajectory of the pandemic going forward and thus, in particular, on the success of the vaccination campaigns. In the United States and the United Kingdom, where roughly half the population has already received at least one dose of the vaccine, many contact-intensive services have been reopened since March. The immediate strong rise in restaurant visits in these countries is a harbinger of a rapid recovery of economic activity in these sectors. As the vaccination campaigns make growing progress, other countries will probably follow their example, too. A broad opening-up of the euro area economy is expected as from the third quarter, if not sooner. For many emerging market economies, however, the short-term outlook is not that rosy. Some countries are currently being overwhelmed by new, severe waves of infections. In addition, the scarcity of vaccines is stunting the progress of vaccination campaigns in many places. According to the International Monetary Fund (IMF), the majority of the population in the emerging market economies will not be vaccinated prior to 2022, which is also likely to put a perceptible dent in their countries' growth outlook.[1]

IMF warns of challenges of internationally asynchronous recovery

Against this background, in its latest World Economic Outlook, the IMF has warned of the challenges potentially associated with internationally highly divergent paths of recovery. Although the IMF now expects strong global GDP growth of 6% this year and 4.4% next year, the upward revision of its global growth forecast is, however, attributable primarily to the improved outlook for industrial countries, especially the United States, whose GDP in 2022 could already return to levels expected prior to the pandemic for that point in time. Most emerging market economies, however, are facing the prospect of sizeable drops in activity over the same period. There are risks associated with such internationally highly divergent economic developments. For instance, if growing overutilisation of capacity and rising inflation rates were to provoke a sudden spike in US yields, this could entail a global rise in yields. This could pose challenges particularly to highly indebted emerging market economies where the recovery is lagging.[2]

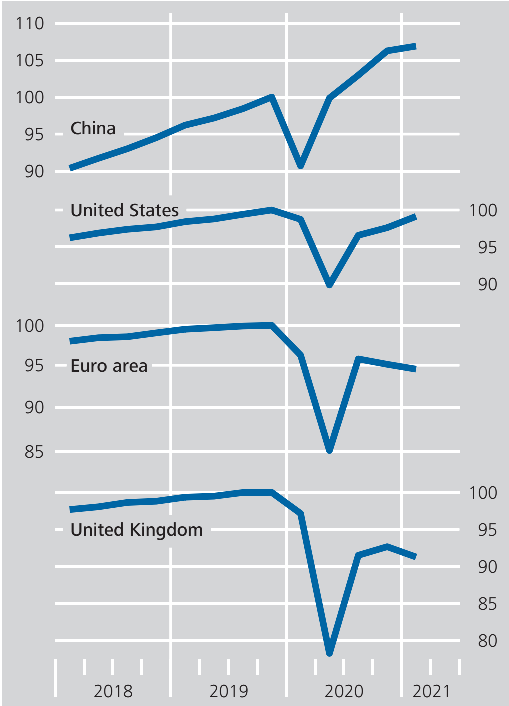
China

Precautionary consumer restraint was a drag on expansion, …

The Chinese economy continued to ride high in the first quarter of 2021. According to an official, seasonally adjusted estimate, real GDP was up by 0.6% on the quarter.[3] Although this represented a marked weakening in the pace of economic activity, this is likely to have been due primarily to a merely temporary bout of consumer restraint on the part of households out of renewed concerns that the pandemic could flare up again. In particular, many Chinese did not travel home for this year's Chinese New Year's festival, as they might have done otherwise, and also eschewed other consumer spending. Some services sectors therefore suffered a marked damper in the quarter just ended.

Real GDP in selected major economies

Q4 2019 = 100, seasonally adjusted, log scale



Sources: National Bureau of Statistics of China, Bureau of Economic Analysis, Eurostat, Office for National Statistics and Bundesbank calculations.

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… yet industrial and export activity remain extremely lively

Industry, however, continued its strong expansion, driven by persistently buoyant foreign demand. In the quarter just ended, revenues from goods exports (denominated in US dollars) were roughly 30% higher than their level immediately preceding the outbreak of the coronavirus pandemic. Chinese export growth thus outpaced global trade growth by a considerable margin. China's export range – which includes, above all, IT equipment, consumer electronics and furnishings – has apparently been a good fit to the needs of many people during the pandemic. In the aftermath of the

1 See International Monetary Fund (2021a).
2 See International Monetary Fund (2021b).
3 The annual growth rate was an exceptionally high +18% since the Chinese economy had been massively impaired by the pandemic in the same period a year earlier.

China's goods exports*

2019 = 100, seasonally adjusted, log scale

Sources: China's General Administration of Customs, CPB and Bundesbank calculations. * On the basis of revenues in US dollars. **1** Volume index.
Deutsche Bundesbank

steep rise in capacity utilisation in industry and the massive increase in commodity prices, producer prices in China increased markedly. Consumer prices, on the other hand, more or less stayed put at their previous year's level in the quarter just ended.

Other selected emerging market economies

Indian economy likely to suffer severe setback owing to new pandemic wave

The economic recovery in India was probably continuing to firm in the first quarter when, over the last weeks of the reporting period, the country was struck by a second, severe wave of the pandemic. The regional authorities imposed extensive containment measures in response to the rapidly escalating health crisis. In some cases, even industrial firms were shut down. On the whole, it is to be feared that the Indian economy's recovery will suffer a severe setback. Although the vaccination campaign is being vigorously pursued, it is likely to drag on for some months to come owing to the size of the population. At its last meeting in mid-April, the central bank kept its policy rates unchanged and also announced a government bond purchase programme. At 4.3% in April 2021, the inflation rate remained within the monetary policy target band of 2% to 6%.

Damper on recovery in Brazil

The economic recovery in Brazil is likely to have made only little progress at the beginning of the year. Adjusted for seasonal effects, industrial production even fell slightly short of its level in the final quarter of 2020. However, record agricultural harvests and higher commodity prices caused export revenues to surge. As regards services, the available indicators are pointing to only moderate growth. One possible factor is that sharply rising infection counts led some states to expand restrictions on public life once again. Despite the progress being made in the vaccination campaign, the pandemic situation remained tense in the last few weeks of the reporting period. In response to rapidly accelerating consumer price inflation, which climbed to 6.8% in April, the central bank hiked its policy rate in two increments of 75 basis points each to 3.5%.

Russian economy continuing to recover

The Russian economy continued to recover at a measured pace. Having contracted in the final quarter of 2020 by as much as 1¾% compared to a year earlier, real GDP was down by 1% on the year in the quarter just ended, according to a preliminary official estimate. Manufacturing output continued to rise, whereas, under the agreements with OPEC, a lid was kept on oil production. However, the sharp rise in oil prices reduced the export revenue shortfalls. Activity in the services sectors picked up substantially in the past few months amidst reduced infection counts yet continued to fall, in some cases, perceptibly short of the previous year's level. Consumer price inflation strengthened to 5.5% on the year in the first quarter. Since the beginning of the year, the central bank has hiked its policy rate by 75 basis points to 5%.

United States

Strong growth thanks to fiscal stimulus, amongst other factors

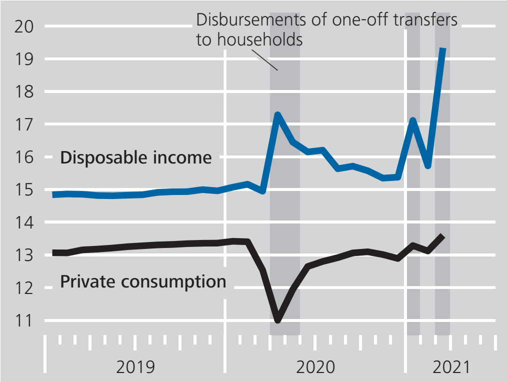
Whereas the recovery process in many economies suffered a setback in the first quarter, the upswing persisted in the United States. According to the preliminary estimate, real GDP increased by 1.6% after seasonal adjustment compared with the final quarter of 2020. But for the severe winter weather which led to considerable cutbacks in production in parts of the southern United States, growth would probably have been even stronger. The US economy benefited, for one thing, from successes in the fight against the pandemic which encouraged many states to ease their containment measures. For another, the strong economic growth also reflected the effects of US fiscal policy. The economic stimulus programme which had already been adopted at the end of 2020 was topped by the passage in March by the new administration of an even larger package (see box on pp. 16 ff.). The measures expanded households' spending scope; new one-off payments caused their disposable income to spike in January and March. Private consumption rose accordingly strongly in the first quarter. Government demand likewise picked up considerably. In addition, business investment was once again stepped up distinctly. However, production was not quite able to keep pace with the lively domestic final demand. Firms therefore destocked their inventories and increased their imports markedly. Given that the economies of many US trading partners were more on the sluggish side, foreign business provided no impetus. On the whole, the US economy has thus nearly returned to pre-crisis levels.

Outlook likewise favourable

According to the latest economic indicators, the US economy remained on a growth track at the change of quarter. Purchasing managers at services and manufacturing firms continued to report strong increases in production, and the situation in the labour market likewise improved further in April. In the coming months, the extraordinary fiscal policy expansion is set to support economic activity, as is the large-scale reopening of the economy which has been promised for the beginning of the third quarter, if not sooner. The growing utilisation of aggregate production capacity is also likely to push up headline inflation, especially since the profit margins of many producers have probably recently been placed under considerable pressure by rising costs of intermediate inputs. In the period up to April, the inflation rate as measured by the consumer price index (CPI) climbed to 4.2%, and the core inflation rate excluding energy and food prices to 3.0%. Factors here included not only base effects and price normalisations but also steep increases in prices for some services in the aftermath of the easing of restrictions. In addition, the prices of used cars rose sharply, which may be associated with production stoppages at car manufacturers. This means that the currently high inflation rates are due primarily to temporary factors. The extremely expansionary stance of US fiscal policy, however, is set to keep supporting inflation. The US Federal Reserve, classifying the strengthening of inflation at the end of April as temporary, announced that it would maintain its accommodative monetary policy stance for the foreseeable future.

Private consumption and income in the United States

In trillion 2012 US$, chain-linked, seasonally adjusted, monthly, annualised



Sources: Bureau of Economic Analysis and Haver Analytics.
Deutsche Bundesbank

Japan

Considerable contraction of economic output

As a result of pandemic-induced restrictions, Japan's economy got the new year off to a weak start. According to the initial official estimate, real GDP in the first quarter fell by a seasonally adjusted 1.3% on the previous quarter, in which it had grown by 2.8%. The main factor behind the GDP contraction was private consumption: households cut back on their

The macroeconomic implications of the American Rescue Plan

US fiscal policy has remained extremely accommodative under the new Biden Administration. Less than two months after President Biden took office, a new stimulus package, the American Rescue Plan, was passed. Its scope even dwarfs that of the last fiscal package just adopted at the end of 2020.[1] According to estimates by the nonpartisan Congressional Budget Office (CBO), the additional burdens on public finances could amount to nearly US$1.9 trillion, or just under 9% of US annual GDP.[2] The spending will be on the following items, in particular: new direct payments to households, a temporary increase in unemployment benefits and tax relief for families, but also funds for state and local governments, for schools, and for combatting the virus. Owing to the short-term nature of many of the provisions, the lion's share of the funds are likely to be disbursed this year already.[3] The US administration hopes that these measures will cushion the financial impact of the pandemic and simultaneously pave the way for a sustainable economic recovery. Critics, however, are pointing to the risks of an overheating of the US economy, rising inflation and higher interest rates.[4] The international spillover effects of the US fiscal package are also controversial.

This box analyses the likely macroeconomic effects of the fiscal package using simulation studies. The simulations are performed using not only NiGEM, the semi-structural model of the National Institute of Economic and Social Research (NIESR), but also EAGLE, the dynamic stochastic general equilibrium model developed by Eurosystem experts.[5] Both models enable a fairly detailed representation of the measures.[6] Since they take into account multiple countries and regions of the world, inferences about the international spillover effects can also be drawn on the basis of the simulations.

The simulation results consistently show that the new fiscal package is likely to deliver a considerable stimulus to the US economy in the short term. This year, real GDP could be between 2½% and just under 3% higher than if fiscal policy remained unchanged. This would more than close the US output gap.[7] Domestic inflationary pressures therefore increase markedly in the simulations because, amongst other things, a US monetary policy response to accelerating inflation is ruled out until 2022.[8] Overall, in both simulations, annual US con-

1 Estimates put the fiscal costs of the stimulus package introduced in December 2020 to extend or renew major crisis response measures in the short term at just over 4% of gross domestic product (GDP).
2 The estimates refer to the federal budget. The model calculations provide for slightly weaker stimulus since it is assumed that the transfers will only be partially disbursed to state and local governments. The CBO has also applied similar assumptions in the recent past. For more information, see Seliski et al. (2020).
3 The CBO expects 63% of the outlays to occur this fiscal year (i.e. in the second or third quarter of 2021). See Congressional Budget Office (2021a).
4 For more information, see Blanchard (2021), for example.
5 For more information about the models used, see https://nimodel.niesr.ac.uk and Gomes et al. (2012).
6 In the simulations, higher payments to households were modelled as government transfers. The EAGLE model assumes that a disproportionately large share of these payments will flow to households that do not have access to the capital markets and that therefore have a high propensity to consume out of disposable income. Tax relief for families was incorporated through calibrated reductions of the effective income tax rates. In the simulations, the other measures increase either government consumption or public investment.
7 Before the most recent fiscal package was approved, the CBO anticipated an output gap of 1.8% of potential output for 2021 as a whole. See Congressional Budget Office (2021b).
8 In NiGEM, expectations of future policy tightening lead immediately to a rise in long-term interest rates and an effective appreciation of the US dollar with a dampening effect on inflation. By contrast, in the EAGLE simulations, the US dollar even depreciates slightly.

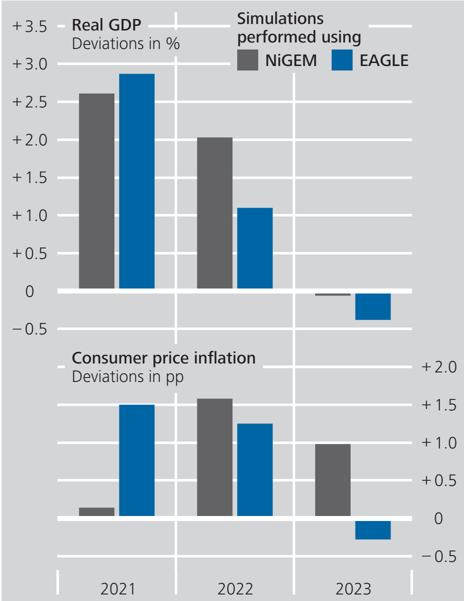
sumer price inflation rises by an average of almost one percentage point between 2021 and 2023. When the first measures expire and endogenous adjustment responses kick in, the model calculations suggest that the real economic effects will diminish rapidly. Most of the stimulus effect is likely to have already worn off by 2023.

Macroeconomic developments in the United States spill over to other economies through various channels. According to the simulations, German exporters, like other trading partners of the United States, are likely to derive short-term benefit from the sharp upturn in demand there. At the same time, yields on the long-term government bonds of other countries could also rise as a result of the interest rate linkage with the United States.[9] The results of the simulation indicate that, all in all, the growth-stimulating effects of the US fiscal package will probably prevail to a small degree in other regions, too. According to the model calculations, the level of GDP in the euro area could rise by between 0.1% and 0.3% this year.

Although the different models produce very similar assessments of the macroeconomic implications of the American Rescue Plan,[10] it should not be forgotten that simulations performed for such extensive packages of measures are subject to a high degree of uncertainty, particularly in the current setting. One question this raises is whether, given that some pandemic-related restrictions remain in effect in the United States, too, the fiscal stimulus provided by these measures will be weaker in the short term but potentially last longer.[11] Past experience also suggests that the relationship between macroeconomic capacity utilisation and inflation has weakened over time. The inflationary and interest rate-increasing effect of the stimulus might therefore be overestimated.[12] On the other hand, the analyses do not take into account that, over the last few weeks, the US government has already forged ahead with plans for additional spending programmes aimed at strengthening the public infrastructure and providing financial support to families. These projects will probably further increase the degree of fiscal expansion in the United States

Macroeconomic effects of the American Rescue Plan in the United States*

Deviations from the baseline or the long-term growth equilibrium



Sources: Bundesbank calculations based on CBO's cost estimates. * Results of Bundesbank simulations assuming that monetary policy rates remain unchanged until the end of 2021.
Deutsche Bundesbank

9 In the simulations using NiGEM, for instance, ten-year government bond yields rise directly by 0.4 percentage point in the United States and by just under 0.2 percentage point in the euro area. Similar movements have also been observed in the financial markets since the beginning of February.
10 Moreover, the GDP effects identified for the United States are largely in keeping with the estimations by other institutions; see European Central Bank (2021), OECD (2021) and German Council of Economic Experts (2021).
11 Last year, the CBO, for instance, made similar assumptions for its assessment of fiscal measures; see Seliski et al. (2020).
12 In studies which assume a much flatter Phillips curve, ECB economists calculate an increase of just 0.2 to 0.4 percentage point in core US consumer price inflation, for example; see European Central Bank (2021).

– at least in the short term.[13] If the growing overutilisation causes US yields to rise further than they have until now, this could entail a global rise in yields, which is likely to pose a challenge to emerging market economies with high levels of external debt, in particular.[14] However, such risk scenarios can only be hinted at in the macroeconomic models used here.

13 Funding for the US$2.3 trillion earmarked for the country's physical and digital infrastructure and for promoting industry under the American Jobs Plan is to be covered in the long term through higher corporate taxes. The similarly large additional expenditure for families under the forthcoming American Families Plan will be funded by increases in taxes on the highest earners. Overall, however, over the next few years, the additional spending is likely to initially markedly exceed revenue.
14 See International Monetary Fund (2021b).

consumption of services. Following a strong increase, business investment fell perceptibly as well. In addition, government demand dropped steeply as some stimulus measures expired. Moreover, export growth diminished considerably in the first quarter, which was probably attributable, amongst other factors, to the global shortage of semiconductors, which weighed on car exports.[4] The labour market situation, however, remained robust, with the unemployment rate dropping slightly in the first quarter of 2021 to 2.8%. The annual growth rate of the CPI in March remained in deflationary territory. Against this backdrop, the Japanese central bank maintained its expansionary monetary policy stance.

United Kingdom

In the first quarter of 2021, the UK economy took a considerable hit. GDP was down by 1.5% from the fourth quarter after seasonal and price adjustment. The tightening of containment measures at the beginning of the year constrained, in particular, many services industries sharply. The new barriers to trade with the EU since the beginning of the year have weighed on economic life as well.[5] They dampened manufacturing production, in particular, which contracted perceptibly following a substantial recovery which had begun in the third quarter. Exports of goods to the EU were down by 22% from the final quarter of 2020, whereas those to non-EU countries decreased only marginally. The situation on the labour market continued to dip in line with the contraction of economic activity. Although the unemployment rate remained unchanged at around 5%, the number of staff on furlough rose from its fourth-quarter mark to over 4½ million in February. Following successes in fighting the pandemic, and thanks to the quick progress made

Strict containment measures and new barriers to trade with EU cause GDP contraction

4 See Bank of Japan (2021).
5 See Deutsche Bundesbank (2021a).

in the vaccination campaign, reopening measures were introduced in the past few weeks. Against this background, sentiment amongst enterprises brightened considerably. In March, the Composite Purchasing Managers' Index rose above the expansion threshold; in April, it picked up even further. With inflation still moderate, at the beginning of May the Bank of England maintained its accommodative monetary policy stance.

Poland

New wave of pandemic was a drag on recovery in March

In Poland, the easing of containment measures initially boosted the economic recovery in the first quarter. However, new infection counts subsequently rose so steeply that stricter containment measures were re-imposed nationwide in March, which weighed perceptibly on economic activity. Nonetheless, thanks to the good start to the quarter, real GDP picked up by 0.9% in the first quarter after seasonal adjustment, having contracted as late as the fourth quarter of the previous year. A key factor here was industrial production, which grew strongly in the first quarter and, as the reporting period came to a close, was even far above its pre-crisis growth path. Retail sales, too, were up distinctly compared with a weak preceding quarter after price adjustment, owing to the temporary opening of shops. Owing to government support measures, the labour market so far appears to be largely unfazed by the crisis. The average unemployment rate for the first quarter, at 3.1%, was a mere 0.2 percentage point up on the year. The annual consumer price inflation rate increased in April once again, reaching 4.3%. The core inflation rate excluding energy and food remained elevated at 3.9%. However, the Polish central bank held its policy rate steady at a historically low level of 0.1%.

Macroeconomic trends in the euro area

Renewed decrease in GDP in Q1

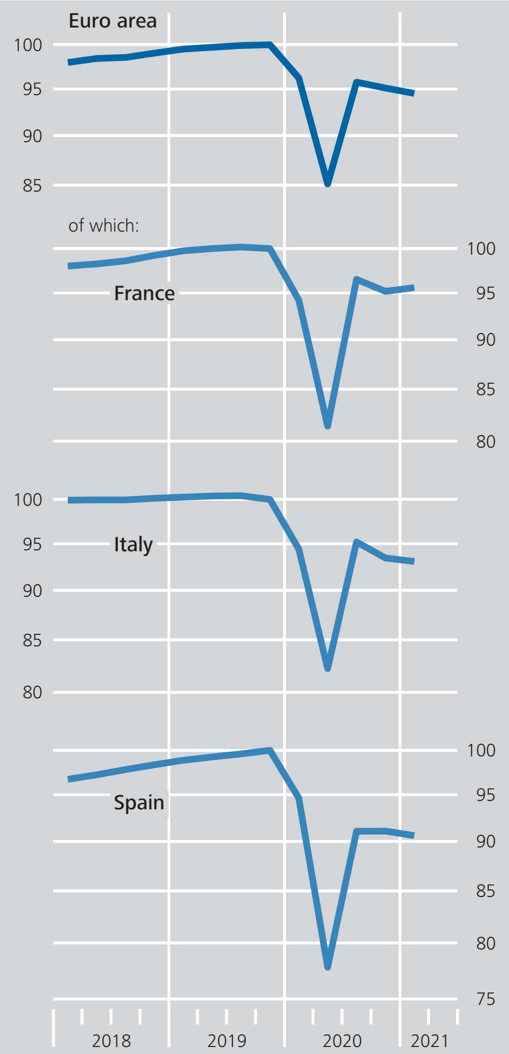
As a consequence of the pandemic and the measures taken to contain it, economic output in the euro area saw another slight decrease in the first quarter of 2021. According to Eurostat's flash estimate, seasonally adjusted real GDP fell by 0.6% in the first quarter of 2021 compared with the fourth quarter of 2020. The amount by which it lagged behind its pre-crisis level thus grew to 5.5%. In view of rising infection rates, numerous Member States had reintroduced stricter measures to contain the pandemic. Various services sectors suffered as a result. By contrast, other sectors less affected by the measures maintained their level of activity or even stepped it up. The main winner in this regard was industry, which benefited from the global shift in demand towards goods. This kept the GDP loss in the euro area within narrow bounds.

Pandemic situation after start of year still fraught; regional adjustments to containment measures

In large parts of the euro area, the pandemic situation remained fraught well into the second quarter. It was only more recently that signs of improvement could be seen. The way in which the pandemic progressed differed from region to region, however – in some cases significantly. In some countries, COVID-19 cases had already reached a peak at the start of the first quarter, with the curve then flattening, whereas in others the situation worsened over the course of the quarter. This was related in part to the emergence of new virus variants. Containment measures were largely tightened and eased in line with the spread of the virus. Overall, the restrictions are likely to have had a slightly stronger impact than in the fourth quarter, which explains the further hit to GDP. In this context, it was primarily the length of time for which individual measures were in place, and less so their severity, that played a role. The containment measures continued to focus primarily on reducing contact between individuals. In particular, they affected the provision of certain services. In addition, face-to-face teaching in educational institutions was temporarily

Aggregate output in the euro area

Real GDP, Q4 2019 = 100, seasonally adjusted, log scale



Sources: Eurostat and Bundesbank calculations.
Deutsche Bundesbank

suspended in some Member States, and in some cases non-essential shops were closed or restrictions on movement imposed. In comparison, the restrictions placed on industry and construction were minimal.

Slow start to vaccination campaign

The COVID-19 vaccination campaign got off to a slow start in the euro area and therefore had barely any influence on the course of the pandemic in the first quarter. One key reason for this was the limited availability of vaccines, which were initially reserved for certain age groups and medical staff. By the end of the first quarter, the percentage of the population that had received at least one vaccine dose was no more than just over 10%, with the pace of vaccination varying slightly across the Member States. It is only in more recent weeks that the speed of the vaccine rollout accelerated significantly.

Still major constraints on private consumption

On the expenditure side, the decline in aggregate output in the first quarter was again due to private consumption. Above all in accommodation and food services, in the arts, entertainment and recreation and in personal services, consumption options were severely limited throughout the entire quarter. Accordingly, money was not spent in these areas, with only some of this money then being spent elsewhere. Due to the closure of many retail outlets, there was a clear quarter-on-quarter fall in retail sales. The number of new vehicle registrations even fell sharply at the start of the year, which was partly attributable to various fiscal incentives expiring at the end of 2020. Consumer willingness to spend remained high, however, as shown by strong sales growth after the easing of restrictions. For example, retail sales rose in February by no less than 4.0% month on month in price and seasonally adjusted terms, and by 3.2% in March.[6] One factor at play here is the fact that, due in part to continued fiscal support, the income situation of the household sector as a whole is likely to have deteriorated only slightly. As a result, the household saving ratio is expected to have risen again.

Slight increase in investment presumed

Gross fixed capital formation probably expanded again in the first quarter, reflecting the significantly improved economic sentiment. Expenditure on machinery and equipment was presumably increased, albeit from a low level. Although capital goods manufacturers' sales in the euro area declined in January and February, imports of capital goods rose again. In addition, the initial country data available indicate that investment in machinery and equipment

6 Excluding motor vehicles and automotive fuel. At the country level, there were in some cases significantly higher monthly rates of increase.

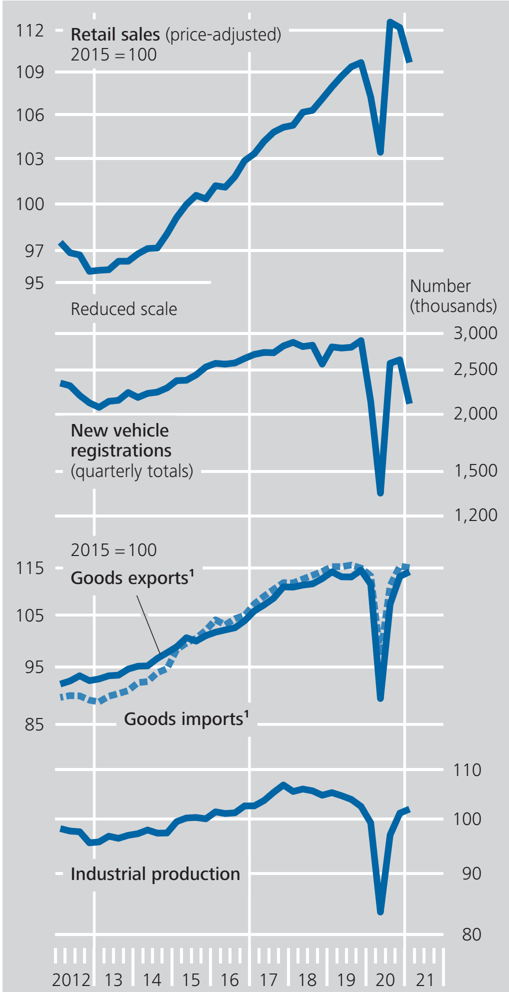
continued to recover. Investment in intellectual property was probably also ramped up as a result of the push towards digitalisation.[7] By contrast, construction investment is unlikely to have exceeded the level seen in the previous quarter. Although investment in housing construction continued to go up, the same could not be said for commercial construction. This could be a reflection of the increased uncertainty surrounding future demand for office and retail space.

Trade in goods with third countries defies Brexit

Foreign trade continued to expand despite the impact of the United Kingdom leaving the Single Market.[8] Whilst exports to the United Kingdom plunged, they were more than offset by flourishing trade with other regions. Exports of goods to China, but also to several European countries such as Switzerland, the EU countries outside the euro area and Russia, saw a marked increase. According to balance of payments data, exports of services from the euro area to third countries also rose slightly in the first two months of the year but still fell significantly short of pre-crisis levels as tourism continued to flounder. Imports to the euro area from third countries went up markedly on the back of overall upbeat industrial activity, especially in the case of intermediate goods. There was a significant increase in trade between euro area countries, especially in intermediate and capital goods.

Economic indicators for the euro area

Seasonally adjusted, log scale



Sources: Eurostat, ECB and Bundesbank calculations. **1** Nominal export and import data according to foreign trade statistics (intra and extra trade). Price-adjusted using the producer price index (exports) or the import price index.
Deutsche Bundesbank

Continued recovery for manufacturing

The rebound in industry continued after the start of the year but lost considerable momentum compared with previous months. On a quarterly average, industrial production rose by 0.8% on the quarter, almost reaching the pre-crisis level recorded in the fourth quarter of 2019. There was once again a very substantial rise in the manufacture of computer, electronic and optical products. The production of intermediate inputs also expanded, especially in the metal-working industry. By contrast, vehicle production had to be cut. Vehicle manufacturers reported a shortage of intermediate inputs, especially semiconductors. Consumer goods production stagnated in the first quarter. Overall, however, industry was in good shape, as also evidenced by the level of capacity utilisation, which rose above the long-term average.

Some services still severely affected by pandemic

Service providers were far worse off. In some sectors, the situation remained highly fraught due to the pandemic. Activity in these is likely to have decreased again in the first quarter of the year. The hotel and restaurant sector, trade

7 In the euro area excluding Ireland. For several years now, the statistical recording of intellectual property investment in the euro area has been strongly influenced by the strategic planning of multinational enterprises domiciled in Ireland; see Deutsche Bundesbank (2018).
8 See Deutsche Bundesbank (2021a).

Sentiment indicators for the euro area*

Balance of positive and negative responses as a percentage of all responses, seasonally adjusted, monthly data

Source: European Commission. * Deviations from the respective average since 2000.
Deutsche Bundesbank

fairs and travel agencies largely remained closed for several months. In many places, art and cultural activities were not yet able to resume, either. The tightening of containment measures also had a negative impact on personal service providers. The situation was more favourable for some business-related services, financial service providers and certain transport services. The ICT sector continued to benefit from the ongoing process of digital transformation and is likely to have upped its output again.

Diverging developments in individual Member States according to progression of pandemic

Economic developments across the Member States were fairly mixed in the first quarter. The main reason for this was differences in the progression of the pandemic and, related to this, in the nature of measures taken in response, as well as differences in economic structure. In most Member States, aggregate activity remained significantly below pre-pandemic levels, with these levels being reached again or even exceeded in only two countries, Luxembourg and Lithuania.

Slight rise in economic output in France

In France, economic output increased by 0.4% in the first quarter compared with the previous period, in which it had contracted by 1.4% due to strict containment measures. Investment activity, which continued to be scarcely affected by the restrictions, was brisk, driven mainly by the strong recovery in construction output. Supported by the easing of strict containment measures at the start of the year, private consumption edged upwards after suffering a sharp setback in the final quarter of 2020. Exports, on the other hand, recorded a distinct reversal of fortune after a strong year-end, due primarily to a slump in vehicle exports. Aggregate output fell just over 4% short of its pre-crisis level in the first quarter. The gap remained considerable in the case of exports and private consumption, whereas investment only barely undershot its pre-crisis level.

GDP in Italy down further

In Italy, economic output dropped further in the first quarter, by 0.4%. This meant that real GDP remained around 7% down on its pre-pandemic level. The spread of the virus was fairly dynamic, with pronounced regional differences at times. Containment measures were adjusted in line with the severity of the pandemic. As a result, private consumption and consumption-related services faced significant restrictions again. By contrast, activity picked up in other sectors of the economy. For example, there was a significant increase in industrial production, particularly of intermediate but also consumer goods. Construction output likewise went up substantially, having already exceeded its pre-pandemic level in the third quarter of 2020. A slight uptick in exports was also recorded. At the same time, imports expanded on the back of strengthening industrial activity.

Moderate GDP decline in Spain from already depressed level of activity

In Spain, aggregate output in the first quarter was down by 0.5% on the quarter. Economic output thus remained around 9% below its pre-pandemic level. In particular, consumer spending was curbed again in the first quarter. One reason for this was that the measures taken to contain the spread of the virus were only eased in the course of the quarter. Industrial production declined due to a strong cutback in motor vehicle production. Construction activity decreased very sharply to well below its pre-crisis level again. The export volume was broadly unchanged, but at the same time there was a marked decline in imports in view of weak domestic economic activity.

Economic developments also varied in smaller Member States

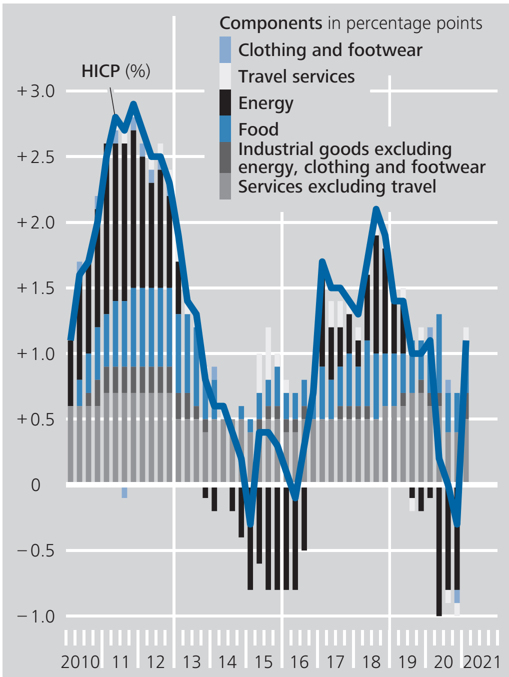
The picture was also mixed in the smaller Member States. In some countries, such as Lithuania, economic output actually increased significantly despite the fraught pandemic situation. In a number of other countries, such as Belgium, Austria and Finland, economic output expanded moderately, with fairly robust industrial activity making a significant contribution to this. In the Netherlands, Portugal and Latvia, on the other hand, it decreased, in some cases significantly. These countries were for a time very badly affected by the pandemic and resorted to imposing relatively strict, longer-lasting measures to contain it.

Little change on labour market – however, it will only be possible to assess situation after government programmes have come to an end

The labour market situation remained comparatively stable. The number of persons employed fell in seasonally adjusted terms by 0.3% in the first quarter. It thus fell just over 2% short of its pre-crisis level. The number of unemployed persons decreased markedly up to March. On a quarterly average, the unemployment rate was thus 8.2%. However, this still left it 0.9 percentage point higher than in the first quarter of 2020. When interpreting the labour market figures, however, it should be taken into account that extensive government support measures are continuing to benefit the labour market. Although the use of short-time working schemes has already been scaled back significantly in most euro area countries, it remains to be seen – especially in sectors particularly badly affected by the pandemic and containment measures until recently – how quickly and to what extent firms will find their way back to profitable business models and protect jobs without external assistance.

Breakdown of the annual HICP rate in the euro area*

Quarterly averages



Sources: Eurostat and Bundesbank calculations. * Due to rounding, there may be slight differences between the annual HICP rate and the sum of the components.

Deutsche Bundesbank

Consumer prices in euro area soared in Q1; annual inflation rate clearly positive again

In the first quarter of 2021, the Harmonised Index of Consumer Prices (HICP) rose sharply on the quarter in seasonally adjusted terms. The headline annual inflation rate increased from -0.3% in the fourth quarter of 2020 to 1.1%. The rate excluding energy and food also jumped considerably from 0.2% to 1.2%. Various factors were at play here. First, energy prices rose sharply. Second, prices of other non-energy industrial goods, which had still been in decline in the fourth quarter of 2020, rose, with a weaker end-of-season sales effect in individual countries being significant. Durables also became markedly more expensive. Third, the fact that the temporary lowering of VAT rates in Germany expired at the end of 2020 contributed to the upward pressure on prices. Lastly, the annual rate of HICP inflation was still being driven up by a statistical effect in connection with adjustments to the weighting scheme.[9] The rate excluding energy, food, travel and clothing, which is generally less affected by one-off effects, rose by just 0.3 percentage point to 1.1% in the first quarter, of which an estimated 0.2 percentage point was due to the VAT effect in Germany.

Further rise in inflation rate in April

In April, the annual rate of HICP inflation rose to 1.6%. By contrast, the rate excluding energy and food slipped slightly to 0.7%, which was largely attributable to the reduced contribution of the one-off statistical effect. The annual headline rate of HICP inflation is likely to hover around 1½% over the next few months before, due in part to base effects, rising temporarily to well above 2% up to the end of the year. The global rise in intermediate goods prices is likely to have a delayed effect on the consumer prices of individual products, but this will be particularly pronounced for energy and food. As things currently stand, the impact on the core rate of HICP inflation is likely to be rather low. However, the greater price pressures at the upstream stages of the production value chain present a certain upside risk to the price outlook.

Significant improvement in state of economy to be expected in current quarter

The state of the euro area economy is expected to improve markedly in the course of the second quarter. In many places, the containment measures were not only extended at the start of the second quarter but in some cases even tightened in response to rising cases of infection. However, the vaccination rollout gathered considerable steam and there were also growing signs as this report went to press that the pandemic was slowing down. Extensive steps for reopening the economy were therefore set out in a number of Member States. These are expected to enable various economic sectors to expand their activity significantly. However, the full effect of this is not likely to be felt until the third quarter. The underlying upward trend for the global economy will also have a propping-up effect. In any case, economic sentiment continued to brighten in April. A significant improvement in business prospects and, in some cases, in business conditions was reported across all sectors. Once again, various confidence indicators even exceeded their respective long-term averages. The key to how strong the macroeconomic recovery will be in the months to come will probably be how quickly contact-intensive services and tourism normalise and how quickly the shortages of important intermediate inputs can be overcome.

9 This effect temporarily increases the annual rate of HICP inflation without being based on a corresponding increase in prices. See Deutsche Bundesbank (2021b).

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