ECOWEEK

N°22-29

18 July 2022

ECONOMIC RESEARCH

BNP PARIBAS

The bank
for a changing
world

ECB: ADDRESSING UNWARRANTED SPREAD WIDENING

Next Thursday's meeting of the ECB Governing Council is eagerly awaited. The rate hike decision has been pre-announced so the more important question is whether the new tool to address unwarranted sovereign spread widening will be unveiled. The rationale for such an instrument is well understood but its design and use raise several questions. One is easy to answer. To avoid a conflict with the monetary policy stance, bond purchases by the central bank would need to be sterilized. The others are more challenging. Where is the threshold to call a spread widening 'unwarranted'? Should the ECB be clear or ambiguous on this threshold and on its reaction when it would be reached? The final question concerns moral hazard and, hence, conditionality. When the ECB intervenes to address unwarranted spread widening, what are governments supposed to do in return in terms of fiscal policy?

Next Thursday's meeting of the ECB Governing Council is eagerly awaited. The rate hike decision has been pre-announced so the focus will be on whether there is any finetuning of the guidance against the background of weaker survey data.

The more important question however is whether the new tool to address unwarranted sovereign spread widening will be unveiled. The purpose of this Transmission Protection Mechanism[1] is to fight fragmentation risk inside the euro area that would result from a disconnect between government bond spreads and their fundamentals.

Back in March, Christine Lagarde had insisted on the Governing Council's readiness to *"use a wide range of instruments to address fragmentation"*, adding that, *"if necessary, we can design and deploy new instruments to secure monetary policy transmission as we move along the path of policy normalization."*[2] A sense of urgency grew in June when sovereign spreads widened significantly, triggering an *ad hoc* meeting of the Governing Council on 15 June to discuss the market situation and leading to a statement that flexibility will be applied in reinvesting redemptions in the PEPP portfolio. Moreover, it had been decided *"to mandate the relevant Eurosystem Committees together with the ECB services to accelerate the completion of the design of a new anti-fragmentation instrument for consideration by the Governing Council."*[3]

Addressing fragmentation risk is of major importance to avoid that monetary transmission would be impacted by an excessive increase in bond yields in certain countries, giving rise to a negative feedback loop and destabilizing dynamics. However, the design and use of the – yet to be announced – tool require that several questions be answered.

Firstly, when is a spread widening considered to be unwarranted? Answering this question is a challenge because years of asset purchases as well as the Covid-19 pandemic and the ECB's policy reaction (PEPP) have influenced interest rate differentials between euro area countries. Moreover, the recent spread widening occurred in an environment of rising yields on German government bonds, which are considered risk-free and are therefore used as a benchmark in the euro area (chart 1).[4] According to recent work by the Bank of Italy, *"a level of the spread between the 10-year Italian and German bonds lower than 150 basis points would currently be in line with the market valuations*

1. Source for the name of this new instrument: ECB Tool Has Name, But Arrival on July 21 Seems Uncertain, Bloomberg website, 7 July 2022; ECB's Stournaras: We will agree on transmission protection mechanism, Reuters, 7 July 2022.
2. Source: *"Monetary policy in an uncertain world"*, Speech by Christine Lagarde, President of the ECB, at *"The ECB and Its Watchers XXII"* conference, Frankfurt am Main, 17 March 2022.
3. Source : ECB, Statement after the ad hoc meeting of the ECB Governing Council, 15 June 2022.

4. For more detail see : *Unwarranted spread widening : measurement issues*, Ecoweek, BNP Paribas, 20 June 2022; *Unwarranted spread widening : measurement issues (part 2)*, Ecoweek, BNP Paribas, 27 June 2022.

SPREAD WIDENING IN 2022

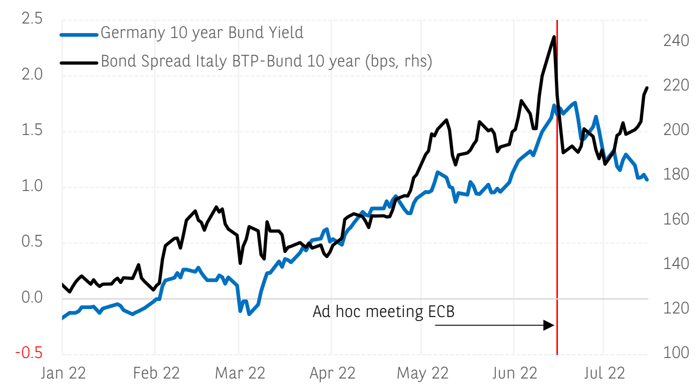


CHART 1 SOURCE: REFINITIV, BNP PARIBAS

> **The ECB, when unveiling its new Transmission Protection Mechanism, will have to answer challenging questions: when is a spread widening 'unwarranted'? Should the ECB be clear or ambiguous on this threshold and on its reaction when it would be reached? How will moral hazard be handled?**

consistent with the macroeconomic fundamentals, while levels higher than 200 points would not be justified."[5]

These results lead us to the second question: should the ECB be clear or ambiguous on its reaction function? The former would imply that thresholds - such as, according to the Bank of Italy calculations, 200 basis points for the BTP-Bund spread - are communicated with the hope that this would slow down speculation when the market is approaching this level: investors might fear that intervention by the ECB would be imminent. However, the opposite cannot be excluded, with investors testing the determination of the central bank in defending a certain spread.

This would call for keeping some ambiguity, although this would inevitably trigger questions during the press conference that follow the Governing Council meetings. The reaction function not only concerns the threshold level for spreads but also, if the spread would have moved beyond, how quickly the central bank would try to bring it back below.

Moreover, what is the appropriate frequency of communicating on the market interventions? Under the Outright Monetary Transactions (OMT), which were introduced in September 2012 following Mario Draghi's famous speech in July that year but never used (chart 2), the aggregate holdings of the Eurosystem and their market value would have been published on a weekly basis and the country details on a monthly basis[6]. Frequent communication about the threshold and market interventions would show decisiveness, but it would also suppose that the policy is effective. Otherwise, there would be a credibility problem that would make matters worse.

Another question concerns the monetary consequences. Bond purchases by the central bank imply the creation of high-powered money. This would need to be sterilized if it would run into conflict with the monetary policy stance, e.g. during a rate hike cycle. Under OMT, the transactions would also have been sterilized.

The final question concerns moral hazard and, hence, conditionality. When the ECB intervenes to address unwarranted spread widening, public finances of the targeted countries benefit - a significant increase in the borrowing cost is being avoided -, which raises the question of what governments are supposed to do in return in terms of fiscal policy?[7] Bundesbank president Joachim Nagel recently argued in favour of designing the bond buying scheme based on the experience of OMT to avoid giving *"the impression of discouraging fiscal policy consolidation"*.[8][9]

SPREAD WIDENING IN 2012

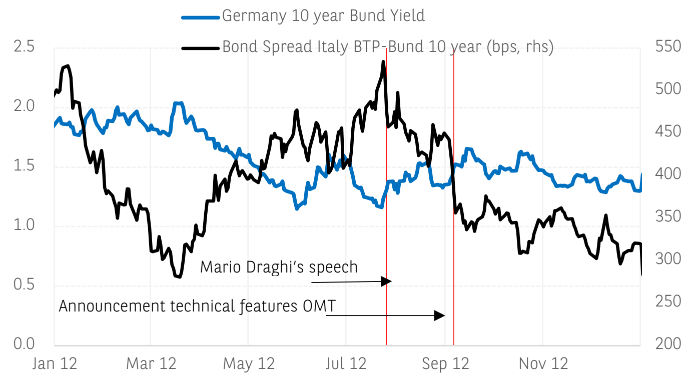


CHART 2 SOURCE: REFINITIV, BNP PARIBAS

Isabel Schnabel, Member of the Executive Board of the ECB, on the other hand noted in February this year that due to the stigma effect, there had been a reluctance to resort to an ESM programme but that Next GenerationEU had shown it is possible to have conditionality without strong stigma effects.[10] This message was recently echoed by her colleague Fabio Panetta, who insisted that the PEPP and Next Generation EU *"clearly show that there are other possibilities that involve flexibility and cooperation, rather than confrontation, between Europe and its Member States."*[11] The debate within the Governing Council will probably be intense.

William De Vijlder

5. Source : Banca d'Italia, Economic Bulletin, 3/2022, July. The fair value spread is calculated using a panel model that includes the main euro area countries. The explanatory variables are debt levels as a share of GDP, short- and medium-term growth expectations and medium-term inflation expectations and the unemployment rate.
6. Source : *ECB, Technical features of Outright Monetary Transactions*, 6 September 2012
7. Absence of fiscal consolidation would influence the warranted spread -as shown in the calculations by the Bank of Italy mentioned in footnote 5, the debt level influences the spread- but it could also increase the likelihood of speculative attacks.
8. Source : *"ECB should model new bond scheme on old one"*, Nagel says, Reuters, 11 July 2022.
9. Under OMT, a necessary condition was *"strict and effective conditionality attached to an appropriate European Financial Stability Facility/European Stability Mechanism (EFSF/ESM) programme."* Moreover, the involvement of the IMF would *"also be sought for the design of the country-specific conditionality and the monitoring of such a programme."* (Source: see footnote 6).

10. Source: ECB, Interview with Financial Times, Interview with Isabel Schnabel, Member of the Executive Board of the ECB, conducted by Martin Arnold on 14 February and published on 15 February 2022.
11. Source: ECB, Interview with La Stampa, Interview with Fabio Panetta, Member of the Executive Board of the ECB, conducted by Marco Zatterin, 5 May 2022.

MARKETS OVERVIEW

OVERVIEW

Week 8-7 22 to 15-7-22				
↗ CAC 40	6 033	▸ 6 036	+0.0	%
↘ S&P 500	3 899	▸ 3 863	-0.9	%
↘ Volatility (VIX)	24.6	▸ 24.2	-0.4	pb
↗ Euribor 3M (%)	-0.09	▸ 0.07	+15.9	bp
↗ Libor $ 3M (%)	2.42	▸ 2.74	+31.5	bp
↘ OAT 10y (%)	1.71	▸ 1.49	-21.2	bp
↘ Bund 10y (%)	1.30	▸ 1.07	-22.5	bp
↘ US Tr. 10y (%)	3.10	▸ 2.93	-17.1	bp
↘ Euro vs dollar	1.02	▸ 1.01	-0.9	%
↘ Gold (ounce, $)	1 746	▸ 1 705	-2.3	%
↘ Oil (Brent, $)	107.2	▸ 101.3	-5.5	%

MONEY & BOND MARKETS

Interest Rates		highest 22			lowest 22		
€ ECB	0.00	0.00	at	03/01	0.00	at	03/01
Eonia	-0.51	-0.51	at	03/01	-0.51	at	03/01
Euribor 3M	0.07	0.07	at	15/07	-0.58	at	05/01
Euribor 12M	1.06	1.12	at	17/06	-0.50	at	05/01
$ FED	1.75	1.75	at	16/06	0.25	at	03/01
Libor 3M	2.74	2.74	at	14/07	0.21	at	03/01
Libor 12M	3.90	3.98	at	14/07	0.58	at	03/01
£ BoE	1.25	1.25	at	16/06	0.25	at	03/01
Libor 3M	1.90	1.90	at	14/07	0.26	at	03/01
Libor 12M	0.81	0.81	at	03/01	0.81	at	03/01

At 15-7-22

Yield (%)		highest 22			lowest 22		
€ AVG 5-7y	1.43	2.21	at	15/06	-0.04	at	03/01
Bund 2y	0.45	1.02	at	14/06	-0.83	at	04/03
Bund 10y	1.07	1.76	at	21/06	-0.14	at	24/01
OAT 10y	1.49	2.17	at	21/06	0.15	at	04/01
Corp. BBB	3.49	4.02	at	21/06	0.90	at	05/01
$ Treas. 2y	3.18	3.43	at	14/06	0.70	at	04/01
Treas. 10y	2.93	3.48	at	14/06	1.63	at	03/01
High Yield	8.91	9.09	at	30/06	5.07	at	03/01
£ gilt. 2y	2.13	2.38	at	21/06	0.69	at	03/01
gilt. 10y	2.08	2.62	at	21/06	0.97	at	03/01

At 15-7-22

EXCHANGE RATES

1€ =		highest 22		lowest 22			2022
USD	1.01	1.15	at 10/02	1.00	at	14/07	-11.4%
GBP	0.85	0.87	at 14/06	0.83	at	14/04	+1.3%
CHF	0.99	1.06	at 10/02	0.99	at	14/07	-4.8%
JPY	139.69	143.95	at 22/06	125.37	at	04/03	+6.7%
AUD	1.48	1.62	at 04/02	1.43	at	05/04	-5.1%
CNY	6.82	7.29	at 10/02	6.75	at	14/07	-5.9%
BRL	5.43	6.44	at 06/01	5.01	at	21/04	-14.3%
RUB	58.71	164.76	at 07/03	56.01	at	29/06	-31.2%
INR	80.51	85.96	at 11/02	79.85	at	14/07	-4.8%

At 15-7-22 *Change*

COMMODITIES

Spot price, $		highest 22			lowest 22			2022	2022(€)
Oil, Brent	101.3	128.2	at	08/03	79.0	at	03/01	+29.2%	+45.8%
Gold (ounce)	1 705	2 056	at	08/03	1 705	at	15/07	-6.4%	+5.6%
Metals, LMEX	3 495	5 506	at	07/03	3 473	at	14/07	-22.4%	-12.4%
Copper (ton)	7 178	10 702	at	04/03	7 160	at	14/07	-26.3%	-16.9%
wheat (ton)	284	4.7	at	17/05	281	at	14/01	+19.5%	+34.8%
Corn (ton)	271	3.2	at	28/06	226	at	03/01	+1.9%	+33.8%

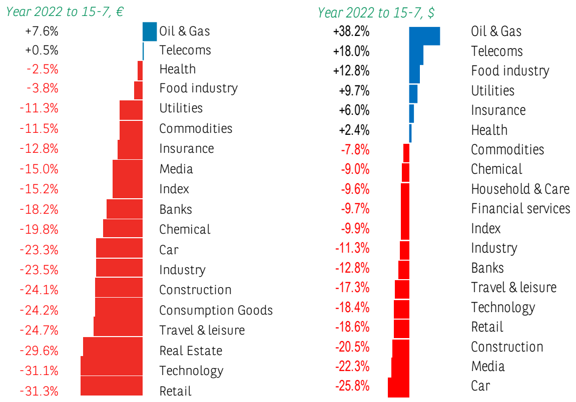
At 15-7-22 *Change*

EQUITY INDICES

	Index	highest 22			lowest 22			2022
World								
MSCI World	2 569	3 248	at	04/01	2 486	at	17/06	-20.5%
North America								
S&P500	3 863	4 797	at	03/01	3 667	at	16/06	-18.9%
Europe								
EuroStoxx50	3 477	4 392	at	05/01	3 360	at	05/07	-19.1%
CAC 40	6 036	7 376	at	05/01	5 795	at	05/07	-1.6%
DAX 30	12 865	16 272	at	05/01	12 401	at	05/07	-19.0%
IBEX 35	7 946	8 934	at	27/05	7 645	at	07/03	-0.9%
FTSE100	7 159	7 672	at	10/02	6 959	at	07/03	-0.3%
Asia								
MSCI, loc.	1 059	1 165	at	05/01	1 024	at	08/03	-0.7%
Nikkei	26 788	29 332	at	05/01	24 718	at	09/03	-7.0%
Emerging								
MSCI Emerging ($)	962	1 267	at	12/01	962	at	15/07	-2.2%
China	68	86	at	20/01	59	at	15/03	-17.7%
India	723	891	at	13/01	699	at	17/06	-8.0%
Brazil	1 333	2 003	at	04/04	1 311	at	14/07	-10.2%

At 15-7-22 *Change*

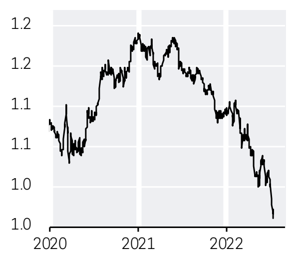
PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)



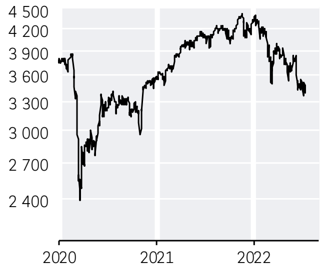
SOURCE: REFINITIV, BNP PARIBAS,

MARKETS OVERVIEW

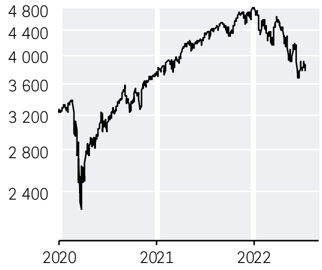
EURO-DOLLAR



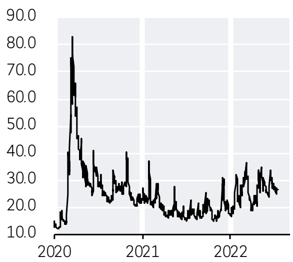
EUROSTOXX50



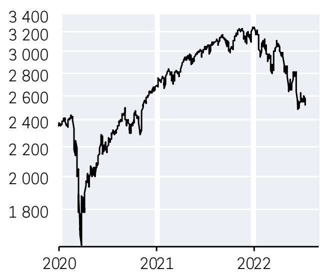
S&P500



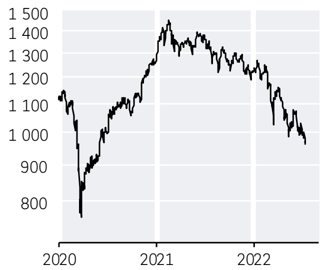
VOLATILITY (VIX, S&P500)



MSCI WORLD (USD)

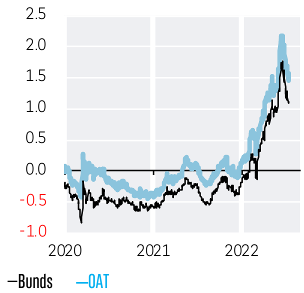


MSCI EMERGING (USD)



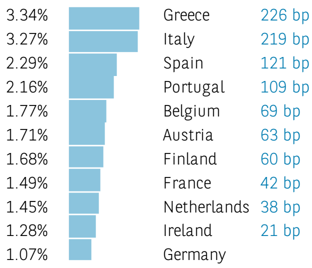
10Y BOND YIELD, TREASURIES VS BUND

10Y BOND YIELD

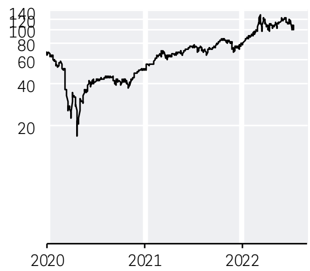


10Y BOND YIELD & SPREADS

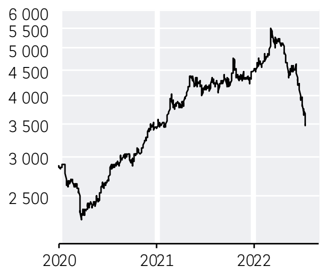
Year 2022 to 15-7



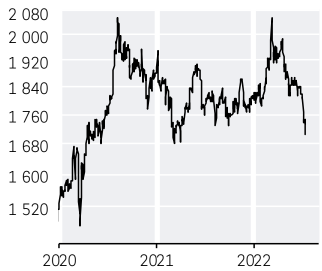
OIL (BRENT, USD)



METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

ECONOMIC PULSE

CHINA: SOFT PATCH

Chinese economic activity contracted by 2.6% quarter-on-quarter in Q2 2022, with almost zero growth (0.4%) year-on-year. This poor performance was primarily the result of mobility restrictions introduced in several of the country's provinces in response to the latest wave of the Covid-19 pandemic, with the strictest restrictions in force from March to May in major economic centres such as Shanghai. The economic shock in Q2 2022 was severe and unexpected, but was nevertheless less violent than that in Q1 2020, when the lockdown measures introduced at the beginning of the crisis resulted in a collapse in activity of 10.3% q/q and 6.9% y/y.

Industrial activity restarted during May, more rapidly than activity in the services sector. Yet, industrial production growth slowed to 0.6% y/y in Q2 2022 as a whole (from 6.5% in Q1 2022). Industrial activity was supported by a rebound in exports, which were hit hard by supply disruptions in the manufacturing sector and difficulties in the transport of goods from March to May. Export performance in June was even a positive surprise (+17.7% y/y in current USD in June and +12.7% in Q2 vs. 14.9% in Q1). Imports of goods increased by only 2.4% y/y in Q2 2022 (from 11.4% in Q1), reflecting weak domestic demand. As a result, the trade surplus increased sharply: it rose from USD163 billion in Q1 to USD228 billion in Q2, and in June set a new record for a single month at USD98 billion.

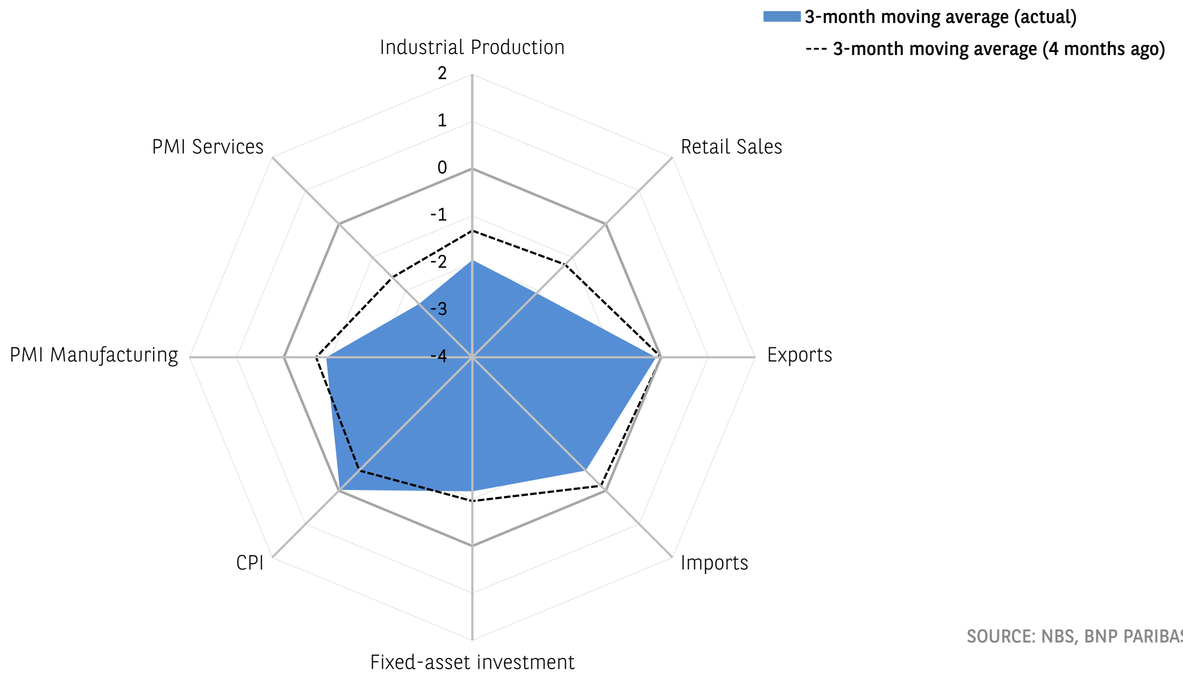
In the services sector, activity fell by 3.3% y/y in Q2 2022 (after an increase of 2.5% in Q1). After three months of contraction, activity in the tertiary sector made only a timid recovery in June (1.3% y/y). Retail sales remained weak: sales volumes fell by 9% y/y per month on average between March and May, and their recovery in June was very feeble (estimated at 0.6% y/y). The crisis in the real estate sector continued to hit the consumption of durable goods and activity in services. In June, property sales volumes fell 18.3% y/y, the 12th consecutive monthly fall.

Chinese consumers are anxious and worried by the possibility of further lockdowns. Growth in real disposable income has been held back by the (still very modest) acceleration in consumer price inflation (from 1.5% y/y in December 2021 to 2.5% in June 2022) and, most importantly, by the deterioration in the labour market. The recovery in activity in June helped bring average national urban unemployment down to 5.5%, from 5.9% in May (compared to 5.1% in June 2021), and the unemployment rate in the country's 31 biggest cities to 5.8% (from 6.9% in May). However, unemployment for those aged between 16 and 24 continued to increase with the arrival of graduates onto the labour market, hitting the record level of 19.3% in June (it was 11.6% in June 2019).

Lastly, domestic investment growth slowed slightly to 6.1% y/y over the whole of the first half of 2022. It was boosted by a small acceleration in infrastructure investment, but manufacturing investment growth continued to decelerate (+10.4% y/y in H1) and real estate investment continued to shrink in June (-5.4% y/y in H1).

Christine Peltier

CHINA: QUARTERLY CHANGES



SOURCE: NBS, BNP PARIBAS

The indicators in the radar are all transformed into 'z-scores' (deviations from the long-term average, as standard deviations). These z-scores have mean zero and their values are between -4 and +2. In the radar chart, the blue area shows the actual conditions of economic activity. It is compared with the situation four months earlier (dotted-line). An expansion of the blue area compared to the dotted area signals an increase in the variable.

ECONOMIC PULSE

UNITED KINGDOM: AN UNEXPECTED RETURN TO GROWTH

The three-month moving average growth for the UK was 0.4% in May (3.5% y/y), above the expectations (0%). The Office for National Statistics (ONS) provides a detailed analysis of monthly changes in economic activity. After contractions in March (-0.1% m/m) and April (-0.2% m/m, against the initial estimate of -0.3%), GDP returned to growth in May (+0.5% m/m). This growth was driven by the three main sectors: services (+0.4% m/m in May), production (+0.9% m/m) and construction (+1.5% m/m).

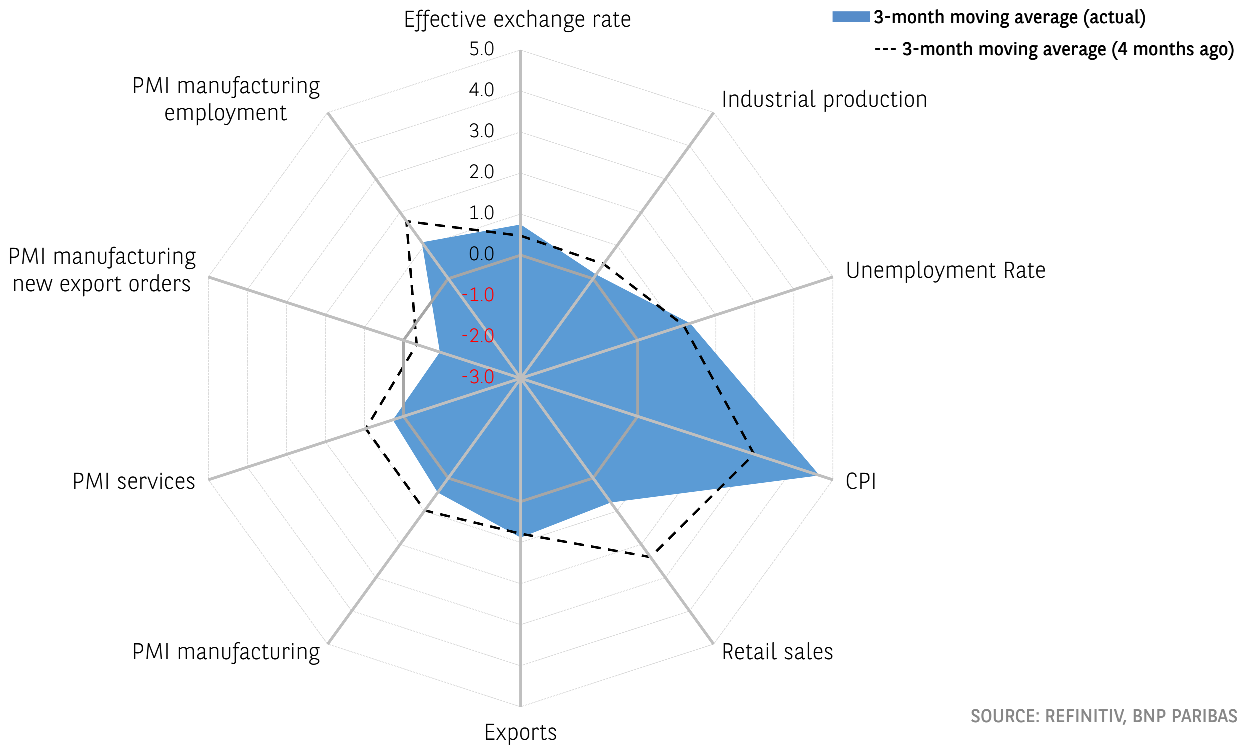
This rebound indicates that the economy has shown some resilience in the face of high inflation, but nevertheless remains fragile. PMI surveys have confirmed declines in business activity levels and confidence in June. The slowdown in the manufacturing sector is continuing, with the PMI dropping from 54.6 in May to 52.8, its lowest level for two years, in June. The Output Index is now close to 50, whilst the New orders index has dropped into contraction territory.

The trend in services is more favourable, for the short term at least. The services PMI improved in June to 54.3 (from 53.4 in May), putting it above the consensus estimate of 53.4. Companies reported an increase in activity in June, but at a slower pace of growth than in the first quarter. With incoming new business falling to their lowest level since February 2021, we could soon see a steeper slowdown. In the face of inflationary pressures and falling consumer demand, companies' Future Business Expectations Index was at its lowest since May 2020.

Inflation continues to drag on growth prospects, and remains at a 40-year high (9.1% y/y in May). The latest forecasts from the Bank of England's Monetary Policy Committee (MPC) suggest that inflation will continue to rise, peaking at around 11% y/y in October. This bounce in UK growth in May will encourage the MPC to continue to raise the Bank's policy rate. Should growth continue into June, it might prompt the BoE to raise bank rates by 50 basis point (bp) at the August meeting, rather than the 25bp hikes approved at each of the last five meetings.

Félix Berte

UNITED KINGDOM: QUARTERLY CHANGES



SOURCE: REFINITIV, BNP PARIBAS

The indicators in the radar are all transformed into 'z-scores' (deviations from the long-term average, as standard deviations). These z-scores have mean zero and their values are between -3 and +5. In the radar chart, the blue area shows the actual conditions of economic activity. It is compared with the situation four months earlier (dotted-line). An expansion of the blue area compared to the dotted area signals an increase in the variable.

ECONOMIC PULSE

SPAIN : ARE CONSUMERS TOO GLOOMY?

Since 8 July, a new governmental scheme has offered an 'anti-inflation' cheque of EUR200 per person to 2.7 million of the most vulnerable Spanish households. This measure is part of a total package of EUR9 billion, approved by the authorities at the end of June. This also includes another cut in VAT on electricity (from 10% to 5%) and a cut in travel costs.

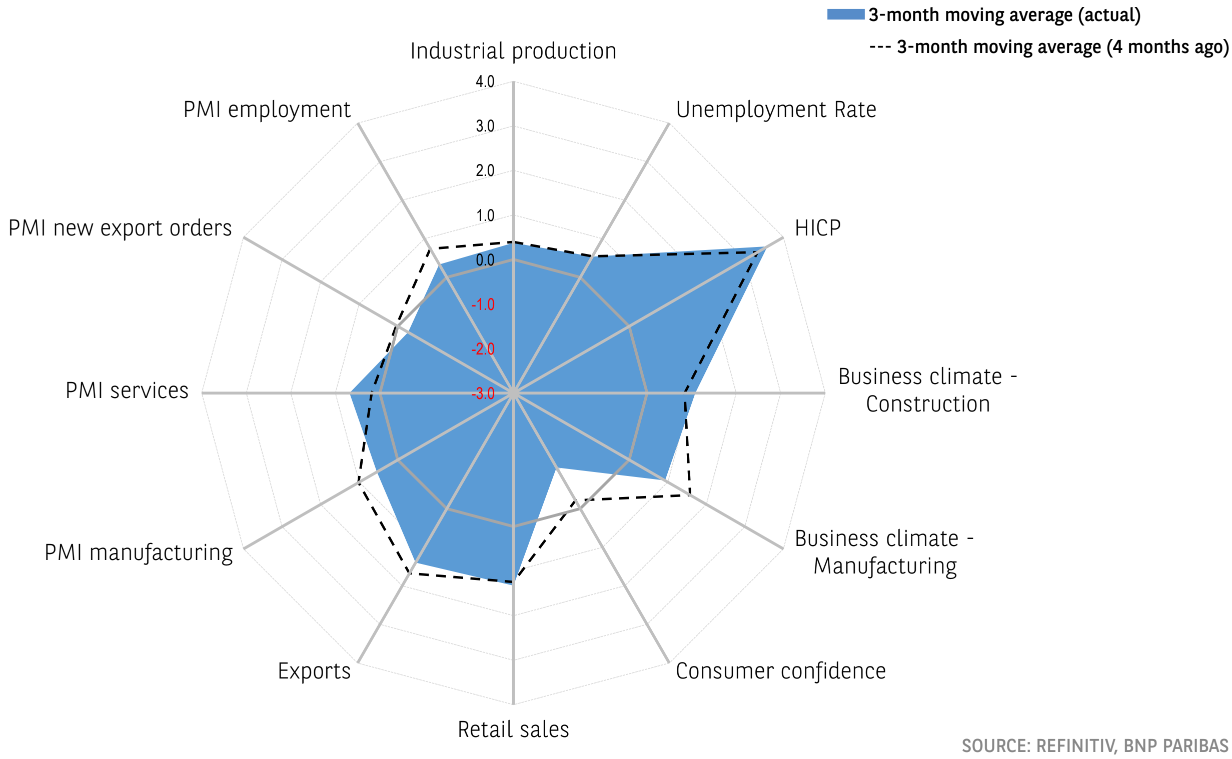
These steps to support households' purchasing power are welcome as inflationary pressures continue to rise. Inflation hit the 10% mark in June (harmonised index), the highest level since the current data series began in 1992. Although rising energy prices (up 40.8% y/y in June) have remained the main contributor to inflation (adding 4.4 points in June), the increase in food prices is amplifying (up 12.9%) and added 2.5 points to total inflation in June. Excluding energy and perishable goods, inflation rose to 5.5%, which again has been the highest level for several decades.

The Spanish economy is nevertheless unlikely to experience a period of recession in 2022. Since the beginning of the year, the composite PMI has been stable in the expansionary zone (53.6 in June) with a rising trend in services (54.0) and resilience in manufacturing (52.6). A significant divergence is therefore emerging between the business and consumers surveys, with the latter seemingly much more pessimistic. According to the European Commission, consumer confidence in June had been at its lowest level since May 2020, period of the first lockdown.

Consumers' pessimism – mainly due to the rise in inflation and its impact on purchasing power – should not discard the fact that the situation in the labour market continues to improve. According to the Spanish employment office (SEPE), net job creation in June was 77,000, the biggest monthly increase for the year so far. Employment volumes grew most strongly in retail (+31,320), hotels (+51,600), and health and social care (+21,940), but fell in education (-49,200) and finance and insurance (-1,230). Furthermore, the number of permanent contracts (full-time and part-time together) rose strongly again, showing that the labour market reforms introduced at the beginning of the year continue to bear fruit. Nearly 240,000 permanent contracts were signed in June, pushing the increase for the first half of the year to more than 1,130,000, a 12% rise. Unemployment increased slightly (by 3,721), but remained below the 3 million threshold.

Guillaume Derrien

SPAIN: QUARTERLY CHANGES



SOURCE: REFINITIV, BNP PARIBAS

The indicators in the radar are all transformed into 'z-scores' (deviations from the long-term average, as standard deviations). These z-scores have mean zero and their values are between -3 and +4. In the radar chart, the blue area shows the actual conditions of economic activity. It is compared with the situation four months earlier (dotted-line). An expansion of the blue area compared to the dotted area signals an increase in the variable.

ECONOMIC PULSE

COVID-19: FOURTH CONSECUTIVE WEEK OF RISING INFECTIONS

Between 5 and 12 July, 6.2 million new cases of Covid-19 were reported around the world, a 15% increase compared with the previous week and the fourth consecutive week of rising infections. Case numbers rose in all regions. Europe saw the largest increase (chart 1): infections rose by 20% to 3 million, representing 48% of the global total. France had the most infections (897,111), followed by Italy (667,381) and Germany (631,866). Currently, 67% of the world's population has received at least one dose of a Covid-19 vaccine, and 12.2 billion doses have been delivered worldwide (chart 2).

Retail and leisure footfall remains high in developed countries. In Germany and France, footfall has been back at pre-pandemic levels since early July, while Belgium reached that milestone in June (chart 3). In Italy, retail footfall seems to be stabilising and remains very close to its pre-Covid level. However, it is still below pre-Covid levels in other countries (Spain, Japan, the UK and the US).

Finally, the OECD weekly tracker (GDP proxy) is continuing to fall in the US and UK, and to a lesser extent in France, Italy and Belgium. However, it remains stable in Spain and Japan. In Germany, the indicator is falling a little more sharply (chart 3, black line). The OECD tracker is based on Google Trends data, reflecting internet searches regarding consumer spending, labour markets, housing, industrial activity and economic uncertainty. The charts here show year-on-year changes in the indicator.

Tarik Rharrab

** Google Mobility Reports show how visits and length of stay at different places change compared to a baseline. The baseline is the median value, for the corresponding day of the week, during the 5-week period Jan 3–Feb 6, 2020. A figure of negative 30% indicates that traffic was down 30% compared to a baseline. The reports show trends over several weeks with the most recent data representing approximately 2-3 days ago—this is how long it takes to produce the reports. In order to smooth the series, we use a seven-day moving average of the raw data in the Google Mobility Reports. Source: Google.*

DAILY CONFIRMED COVID-19 CASES (7-DAY MOVING AVERAGE)

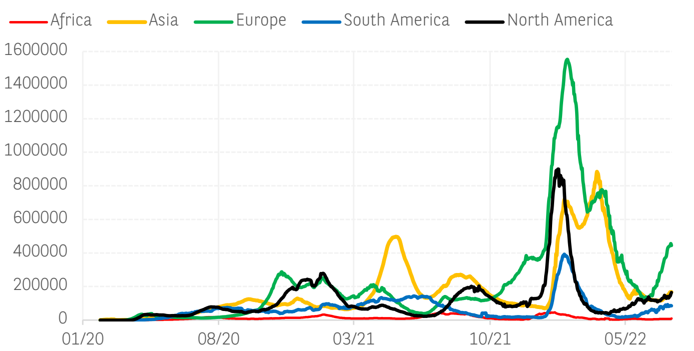


CHART 1 SOURCE: JOHNS-HOPKINS UNIVERSITY (07/13/2022), BNP PARIBAS

SHARE OF PEOPLE WHO RECEIVED AT LEAST ONE DOSE OF VACCINE

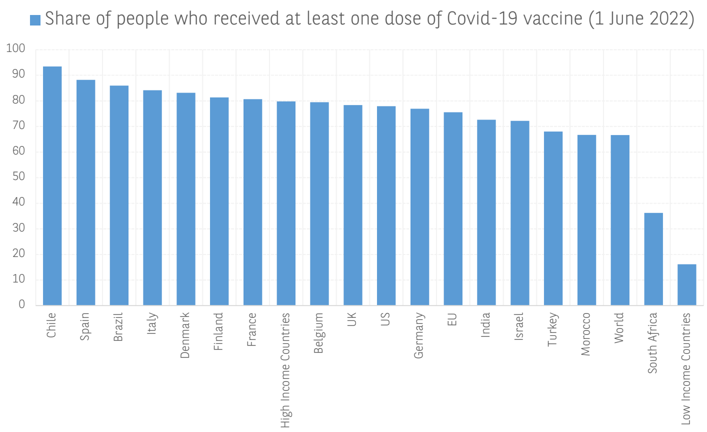
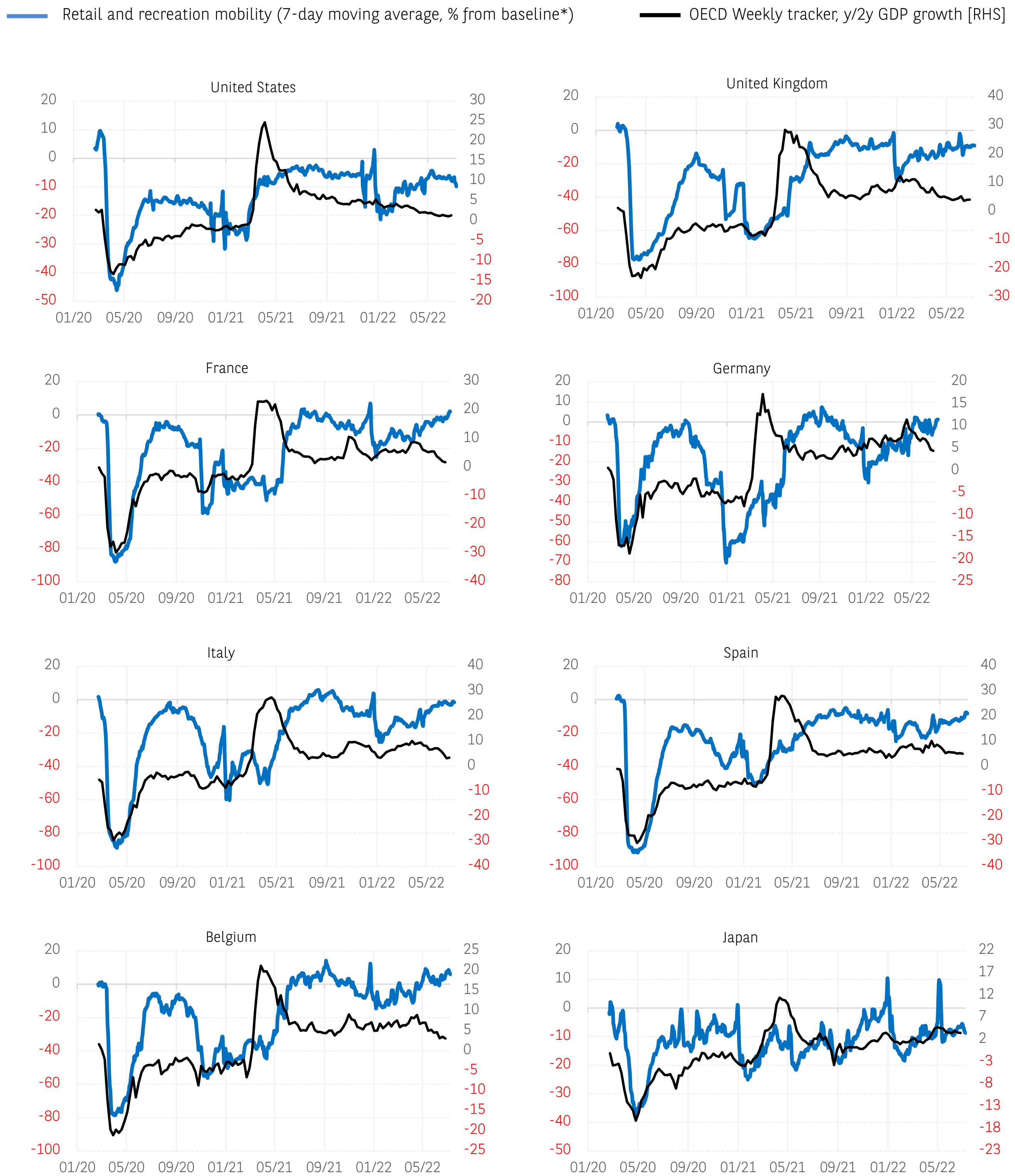


CHART 2 SOURCE: OUR WORLD IN DATA (07/13/2022), BNP PARIBAS

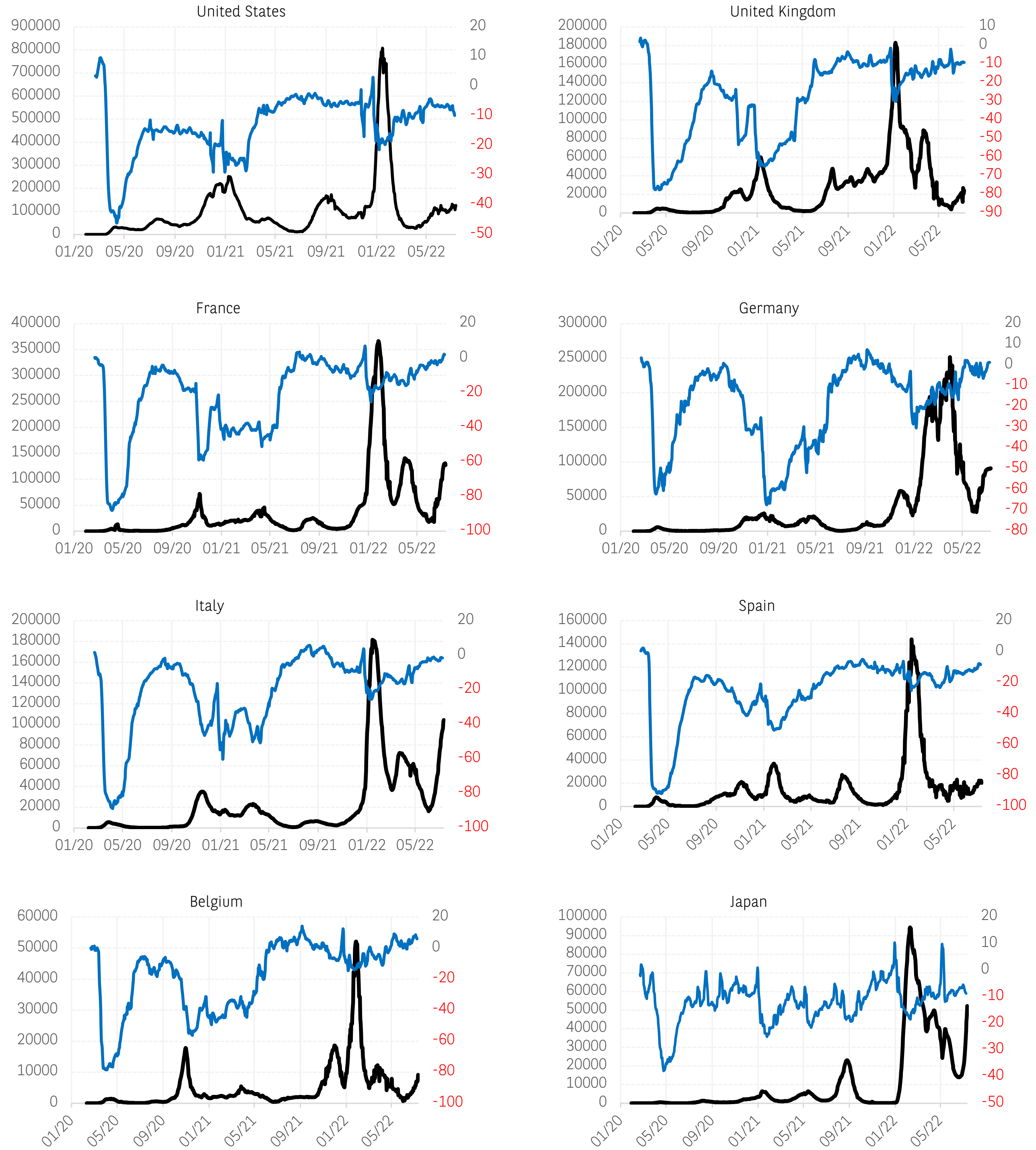
RETAIL AND RECREATION MOBILITY & OECD WEEKLY TRACKER



SOURCE: OECD (07/13/2022), GOOGLE (07/13/2022), BNP PARIBAS

DAILY NEW CASES & RETAIL AND RECREATION MOBILITY

Daily new confirmed cases of Covid-19 (7-day moving average)
Retail and recreation mobility (7-day moving average, % from baseline*)[RHS]



SOURCE: JOHNS-HOPKINS UNIVERSITY (07/13/2022), GOOGLE (07/13/2022), BNP PARIBAS

ECONOMIC SCENARIO

UNITED STATES

Despite a surprising contraction in Q1 2022, the US economy remains dynamic and well supported by household consumption and business investment. The robustness of the labour market which is at full employment, bolsters wages and household consumption. However, inflation, at its highest for four decades, causes a decline in purchasing power. As inflation is higher and more persistent than anticipated, the Federal Reserve is raising sharply the fed funds rate and shrinking its balance sheet. The downward revision of the government's fiscal ambitions, especially its social welfare and environmental plans, may also contribute to moderate growth. Against this background, despite avoiding a recession, the U.S. economy is expected to slow down clearly.

CHINA

Economic activity contracted in April due to the lockdowns imposed in large industrial regions such as Shanghai. This has led us to revise down our real GDP projection for 2022. Economic growth has rebounded since May and the authorities are enhancing fiscal and monetary easing measures. However, short-term downside risks remain high: exports will suffer from the slowdown in global demand, the correction in the property sector should continue, and the recent deterioration in the labour market should weigh on private consumption. Consumer price inflation is accelerating only moderately.

EUROZONE

The surge in inflation that began in early 2021 has morphed into an inflationary shock. Inflation continues to be driven primarily by energy prices but it is also becoming more widespread and thus more persistent. The deterioration of business climate surveys remained limited up until May but consumer confidence has worsened more noticeably. We expect growth to remain positive but weak in the coming quarters. The risk of a recession in the short term is increasing but, should there be one, it would only be technical (limited in duration and extent). The labour market remains robust and the economy still benefits from the cyclical momentum that existed prior to the war in Ukraine, fiscal measures that seek to cushion the impact of inflation on purchasing power, excess savings which are still available and the need to invest. In our scenario (no recession), we expect eurozone growth to reach 2.5% on average over 2022 and 2.3% in 2023.

FRANCE

Real GDP growth entered into negative territory in the 1st quarter of 2022 (-0.2% q/q after +0.4% in the 4th quarter of 2021), as a result of a decrease in household consumption (-1.5% q/q). Higher inflation has pressured households' purchasing power and should also weigh on Q2 expectations. In parallel, corporate investment maintained its growth (+0.4% q/q), as corporates have to cope with output capacity constraints. Overall, in 2022, GDP growth should ease to 2.3% (6.8% in 2021), against a background of higher inflation (5.4% expected in 2022 after 1.6% in 2021).

RATES AND EXCHANGE RATES

In the US, the Federal Reserve will continue its tightening policy at a swift pace. The terminal rate of 3.5% (upper end of the target range) should be reached towards the end of this year. The Fed's hawkish stance is motivated by still very low policy rates against a background of particularly elevated inflation and a strong labour market. When the economy slows down and inflation will be on a downward path, the Federal Reserve should adapt its guidance in an effort to achieve a soft landing. To a very large degree, US Treasury yields already reflect the prospect of monetary policy tightening. This means that year-end levels shouldn't be that different from current levels. For next year we expect somewhat lower yields as growth slows and inflation declines.

The ECB has announced to end its asset purchases at the start of July and to raise its deposit rate later that month. We expect 50bp rate hikes at its September and October meetings, to be followed by five further 25bp hikes between December 2022 and September 2023. This should cause an increase in Bund yields and a widening of sovereign spreads in the euro area.

The Bank of Japan is expected to maintain its current policy stance, at least until Governor Kuroda's term ends in the spring of 2023. Thereafter, we expect the negative interest rate policy to be scrapped and the 10-year rate target to be hiked.

We expect the dollar to weaken significantly versus the euro. The dollar's valuation is expensive, positioning in the market is very long and the long-term interest rate differential should narrow. The yen has already weakened significantly versus the dollar, reflecting the prospect of increased policy divergence between the Fed and the Bank of Japan. We expect the exchange rate to remain around current levels for the remainder of the year. In 2023, the yen should appreciate considering that the federal funds rate should have reached its terminal rate and that the Bank of Japan is expected to tighten policy.

GDP GROWTH & INFLATION

	GDP Growth				Inflation			
%	2021	2022 e	2023 e	2024 e	2021	2022 e	2023 e	2024 e
United-States	5.7	2.6	1.9	1.7	4.7	7.5	3.9	2.4
Japan	1.7	1.4	1.1	0.6	-0.2	1.9	1.0	0.7
United-Kingdom	7.4	3.6	1.5	1.6	2.6	8.0	4.4	2.1
Euro Area	5.3	2.5	2.3	2.2	2.6	7.9	4.1	2.0
Germany	2.9	1.3	2.2	2.3	3.2	8.1	4.6	2.1
France	6.8	2.3	2.1	2.0	2.1	5.9	3.6	1.8
Italy	6.6	2.8	2.0	1.8	1.9	7.7	4.5	1.8
Spain	5.1	4.1	2.5	2.2	3.0	8.0	3.6	1.7
China	8.1	3.7	5.7	5.0	0.9	2.3	3.4	2.5
India*	9.3	8.3	6.2	6.5	5.4	7.9	5.9	5.5
Brazil	4.6	1.5	0.0	1.2	8.3	11.0	7.1	4.3
Russia	4.5	-7.0	0.8	0.3	7.1	14.0	10.5	7.6

SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH (E: ESTIMATES & FORECASTS)
*FISCAL YEAR FROM 1st APRIL OF YEAR N TO MARCH 31st OF YEAR N+1
** LAST UPDATE 06/13/2022

INTEREST & EXCHANGE RATES

Interest rates, %						
End of period		17/06/2022	Q3 2022 e	Q4 2022 e	Q2 2023 e	Q4 2023 e
US	Fed Funds (upper limit)	1.75	3.00	3.50	3.50	3.50
	T-Note 10y	3.24	3.10	3.20	3.10	3.00
Ezone	Deposit rate	-0.50	0.25	1.00	1.75	2.00
	Bund 10y	1.66	1.60	1.80	2.25	2.25
	OAT 10y	2.08	2.15	2.38	2.85	2.85
	BTP 10y	3.57	3.85	4.40	4.65	4.75
	BONO 10y	2.75	2.95	3.40	3.75	3.75
UK	Base rate	1.25	2.00	2.50	2.50	2.50
	Gilts 10y	2.46	2.30	2.50	2.65	2.50
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	0.00
	JGB 10y	0.23	0.24	0.25	0.25	0.45
Exchange Rates						
End of period		17/06/2022	Q3 2022 e	Q4 2022 e	Q2 2023 e	Q4 2023 e
USD	EUR / USD	1.05	1.09	1.12	1.16	1.20
	USD / JPY	135	131	130	125	120
	GBP / USD	1.22	1.25	1.27	1.32	1.36
EUR	EUR / GBP	0.86	0.87	0.88	0.88	0.88
	EUR / JPY	141	143	146	145	144
Brent						
End of period		17/06/2022	Q3 2022 e	Q4 2022 e	Q2 2023 e	Q4 2023 e
Brent	USD/bbl	113	120	122	125	125

SOURCE: BNP PARIBAS (E: ESTIMATES & FORECASTS)
(MARKET ECONOMICS, INTEREST RATE STRATEGY, FX STRATEGY, COMMODITIES DESK STRATEGY
* BASE CASE ** LAST UPDATE 06/17/2022)

CALENDAR

LATEST INDICATORS

The ZEW survey shows that analysts have become significantly more gloomy in July both for Germany and the euro area economy and more so than anticipated by the consensus. In China, second quarter GDP growth barely increased 0.4% versus the previous year, against an expectation of 1.2%. Focusing on the Chinese data for June, export growth accelerated, beating the consensus by a wide margin. Industrial production growth picked up strongly and retail sales increased a lot more than expected. Property investment on the other hand declined further whereas the unemployment rate moved lower. In the US, mortgage applications continue to decline, albeit at a slower pace and consumer prices disappointed strongly with a monthly increase in June well ahead of the previous month and the consensus. Core inflation was also higher but the monthly pace is lagging the headline number. Monthly core producer price inflation was slightly lower in June than in May. Initial unemployment claims increased whereas the consensus had expected a status quo. Retail sales were strong in June compared to the previous month but did also better than anticipated. University of Michigan sentiment improved on the back of a more positive assessment of the current situation. Interestingly, long-term inflation expectations declined.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	ACTUAL	PREVIOUS
07/12/2022	Germany	ZEW Survey Expectations	Jul	-40.5	-53.8	-28.0
07/12/2022	Germany	ZEW Survey Current Situation	Jul	-34.5	-45.8	-27.6
07/12/2022	Eurozone	ZEW Survey Expectations	Jul	--	-51.1	-28.0
07/13/2022	Eurozone	Industrial Production SA MoM	May	0.3%	0.8%	0.5%
07/13/2022	United States	MBA Mortgage Applications	Jul	--	-1.7%	-5.4%
07/13/2022	United States	CPI MoM	Jun	1.1%	1.3%	1.0%
07/13/2022	United States	CPI Ex Food and Energy MoM	Jun	0.5%	0.7%	0.6%
07/13/2022	China	Exports YoY	Jun	12.5%	17.9%	16.9%
07/13/2022	China	Imports YoY	Jun	4.0%	1.0%	4.1%
07/14/2022	United States	PPI Ex Food and Energy MoM	Jun	0.5%	0.4%	0.6%
07/14/2022	United States	Initial Jobless Claims	Jul	235k	244k	235k
07/15/2022	China	New Home Prices MoM	Jun	--	-0.1%	-0.2%
07/15/2022	China	Industrial Production YoY	Jun	4.0%	3.9%	0.7%
07/15/2022	China	GDP YoY	2Q	1.2%	0.4%	4.8%
07/15/2022	China	Retail Sales YoY	Jun	0.3%	3.1%	-6.7%
07/15/2022	China	Fixed Assets Ex Rural YTD YoY	Jun	6.0%	6.1%	6.2%
07/15/2022	China	Property Investment YTD YoY	Jun	-4.2%	-5.4%	-4.0%
07/15/2022	China	Surveyed Jobless Rate	Jun	5.7%	5.5%	5.9%
07/15/2022	United States	Retail Sales Advance MoM	Jun	0.9%	1.0%	-0.1%
07/15/2022	United States	Retail Sales Ex Auto MoM	Jun	0.7%	1.0%	0.6%
07/15/2022	United States	Capacity Utilization	Jun	80.8%	80.0%	80.3%
07/15/2022	United States	U. of Mich. Sentiment	Jul	50.0	51.1	50.0
07/15/2022	United States	U. of Mich. Current Conditions	Jul	53.7	57.1	53.8
07/15/2022	United States	U. of Mich. Expectations	Jul	47.0	47.3	47.5
07/15/2022	United States	U. of Mich. 1 Yr Inflation	Jul	5.3%	5.2%	5.3%
07/15/2022	United States	U. of Mich. 5-10 Yr Inflation	Jul	3.0%	2.8%	3.1%

SOURCE: BLOOMBERG

CALENDAR: THE WEEK AHEAD

COMING INDICATORS

A very busy week in which the focus will be on the ECB meeting and the flash purchasing managers' surveys for July. We will also have consumer confidence for the euro area and the UK as well was French business confidence. In the US, several housing market related data will be published (NAHB index, building permits, housing starts) but, given the concerns about recession risk, attention will also go to the index of leading indicators and the initial unemployment claims. In Japan, the central bank has its monetary policy meeting.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	PREVIOUS	
07/18/2022	United States	NAHB Housing Market Index	Jul	66	--	67
07/19/2022	Eurozone	CPI YoY	Jun F	8.60%	--	8.10%
07/19/2022	Eurozone	CPI Core YoY	Jun F	3.70%	--	3.70%
07/19/2022	United States	Housing Starts MoM	Jun	2.70%	--	-14.40%
07/19/2022	United States	Building Permits MoM	Jun	-1.70%	--	-7.00%
07/20/2022	United Kingdom	CPIH YoY	Jun	8.10%	--	7.90%
07/20/2022	United States	MBA Mortgage Applications	15-juil	--	--	-1.70%
07/20/2022	Eurozone	Consumer Confidence	Jul P	-24.9	--	-23.6
07/20/2022	Japan	BOJ Policy Balance Rate	21-juil	-0.10%	--	-0.10%
07/21/2022	France	Business Confidence	Jul	--	--	104
07/21/2022	Eurozone	ECB Deposit Facility Rate	21-juil	-0.25%	--	-0.50%
07/21/2022	United States	Initial Jobless Claims	16-juil	--	--	244k
07/21/2022	United States	Leading Index	Jun	-0.50%	--	-0.40%
07/21/2022	United Kingdom	GfK Consumer Confidence	Jul	-43	--	-41
07/22/2022	United Kingdom	Retail Sales Ex Auto Fuel MoM	Jun	0.30%	--	-0.70%
07/22/2022	France	S&P Global France Manufacturing PMI	Jul P	51	--	51.4
07/22/2022	France	S&P Global France Services PMI	Jul P	53.1	--	53.9
07/22/2022	France	S&P Global France Composite PMI	Jul P	--	--	52.5
07/22/2022	Germany	S&P Global/BME Germany Manufacturing PMI	Jul P	51	--	52
07/22/2022	Germany	S&P Global Germany Services PMI	Jul P	51.5	--	52.4
07/22/2022	Germany	S&P Global Germany Composite PMI	Jul P	50.1	--	51.3
07/22/2022	Eurozone	S&P Global Eurozone Manufacturing PMI	Jul P	51	--	52.1
07/22/2022	Eurozone	S&P Global Eurozone Services PMI	Jul P	52	--	53
07/22/2022	Eurozone	S&P Global Eurozone Composite PMI	Jul P	51.2	--	52
07/22/2022	United Kingdom	S&P Global/CIPS UK Manufacturing PMI	Jul P	52	--	52.8
07/22/2022	United Kingdom	S&P Global/CIPS UK Services PMI	Jul P	53.5	--	54.3
07/22/2022	United Kingdom	S&P Global/CIPS UK Composite PMI	Jul P	52.8	--	53.7
07/22/2022	United States	S&P Global US Manufacturing PMI	Jul P	51	--	52.7
07/22/2022	United States	S&P Global US Services PMI	Jul P	52	--	52.7
07/22/2022	United States	S&P Global US Composite PMI	Jul P	--	--	52.3

SOURCE: BLOOMBERG

FURTHER READING

The euro at parity versus the dollar: causes, consequences and outlook	EcoTVWeek	15 July 2022
Euro area: Corporation overdrafts returning to pre-pandemic levels	Chart of the Week	13 July 2022
US : An uneasy feeling (part 2)	EcoWeek	11 July 2022
Emerging Countries : From one shock to another	EcoEmerging	11 July 2022
Peru: tempered economic outlook	EcoTVWeek	8 July 2022
Egypt : Deepening of external imbalances	Chart of the Week	6 July 2022
US: an uneasy feeling	EcoWeek	4 July 2022
Let's keep talking about climate change	EcoTVWeek	1 July 2022
US: What does the composite leading indicator tell us about the risk of recession?	Chart of the Week	29 June 2022
Eurozone: European household account: a turbulent story	EcoFlash	28 June 2022
Eurozone: Unwarranted spread widening: measurement issues (part 2)	EcoWeek	27 June 2022
France: when the construction sector goes well, so does the economy	EcoTVWeek	24 June 2022
United States: Fed's new experience in quantitative tightening	Chart of the Week	22 June 2022
Eurozone: unwarranted spread widening: measurement issues	EcoWeek	20 June 2022
Indonesia: weakened by the pandemic, but solid enough to handle new shocks	EcoConjoncture	19 June 2022
Portugal: a resilient economy	EcoTVWeek	17 June 2022
South Africa: a fragile economic recovery	EcoConjoncture	16 June 2022
Central Europe: higher funding costs in bond markets	Chart of the Week	15 June 2022
The worrisome cost of worrying about recession	EcoWeek	13 June 2022

GROUP ECONOMIC RESEARCH

William De Vijlder Chief Economist	+33 1 55 77 47 31	william.devijlder@bnpparibas.com

OECD ECONOMIES AND STATISTICS

Hélène Baudchon Head - Eurozone - Climate	+33 1 58 16 03 63	helene.baudchon@bnpparibas.com
Felix Berte United States, United Kingdom	+33 1 40 14 01 42	felix.berte@bnpparibas.com
Stéphane Colliac France	+33 1 42 98 43 86	stephane.colliac@bnpparibas.com
Guillaume Derrien Southern Europe, Japan - International trade	+33 1 55 77 71 89	guillaume.a.derrien@bnpparibas.com
Anthony Morlet-Lavidalie Germany, Northern Europe	+33 1 53 31 59 14	anthony.morletlavidalie@bnpparibas.com
Veary Bou, Tarik Rharrab Statistics		

ECONOMIC PROJECTIONS, RELATIONSHIP WITH THE FRENCH NETWORK

Jean-Luc Proutat Head	+33 1 58 16 73 32	jean-luc.proutat@bnpparibas.com

BANKING ECONOMICS

Laurent Quignon Head	+33 1 42 98 56 54	laurent.quignon@bnpparibas.com
Céline Choulet	+33 1 43 16 95 54	celine.choulet@bnpparibas.com
Thomas Humblot	+33 1 40 14 30 77	thomas.humblot@bnpparibas.com

EMERGING ECONOMIES AND COUNTRY RISK

François Faure Head – Argentina, Turkey – Methodology, Modelling	+33 1 42 98 79 82	francois.faure@bnpparibas.com
Christine Peltier Deputy Head – Greater China, Vietnam – Methodology	+33 1 42 98 56 27	christine.peltier@bnpparibas.com
Stéphane Alby Africa (French-speaking countries)	+33 1 42 98 02 04	stephane.alby@bnpparibas.com
Pascal Devaux Middle East, Balkan countries	+33 1 43 16 95 51	pascal.devaux@bnpparibas.com
Hélène Drouot South Korea, Philippines, Thailand, Andean countries	+33 1 42 98 33 00	helene.drouot@bnpparibas.com
Perrine Guérin South Africa & English/Portuguese-speaking African countries	+33 1 42 98 43 86	perrine.guerin@bnpparibas.com
Salim Hammad Latin America	+33 1 42 98 74 26	salim.hammad@bnpparibas.com
Cynthia Kalasopatan Antoine Ukraine, Central European countries	+33 1 53 31 59 32	cynthia.kalasopatanantoine@bnpparibas.com
Johanna Melka India, South Asia, Russia, Kazakhstan	+33 1 58 16 05 84	johanna.melka@bnpparibas.com

CONTACT MEDIA

Mickaelle Fils Marie-Luce	+33 1 42 98 48 59	mickaelle.filsmarie-luce@bnpparibas.com

GROUP ECONOMIC RESEARCH

CONJONCTURE
Structural or thematic topics.

EMERGING
Analyses and forecasts for a selection of emerging economies.

PERSPECTIVES
Analyses and forecasts with a focus on developed countries.

ECOFLASH
Data releases, major economic events.

ECOWEEK
Recent economic and policy developments, data comments, economic calendar, forecasts.

ECOTV
A monthly video with interviews of our economists.

ECOTV WEEK
A weekly video discussing the main event of the week.

MACROWAVES
Our economic podcast.

HOW TO RECEIVE OUR PUBLICATIONS

SUBSCRIBE ON OUR WEBSITE
see the Economic Research website

&

FOLLOW US ON LINKEDIN
see the Economic Research linkedin page

OR TWITTER
see the Economic Research Twitter page

Published by BNP PARIBAS Economic Research
Head office: 16 boulevard des Italiens – 75009 Paris France / Phone : +33 (0) 1.42.98.12.34
Internet: www.group.bnpparibas.com - **www.economic-research.bnpparibas.com**
Head of publication : Jean Lemierre / Chief editor: William De Vijlder

BNP PARIBAS

The bank
for a changing
world