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ECONOMIC RESEARCH

BNP PARIBAS

The bank for a changing world

THE RISKS ASSOCIATED WITH TRANSITORY BUT HIGH INFLATION

Although the significant increase in inflation in most advanced economies is expected to be transitory, it is necessary to focus on the potential consequences of inflation staying temporarily high for longer. Companies that hitherto have been reluctant to raise prices might do so after all, higher inflation could weigh on spending but also cause wage demands to grow, inflation expectations could drift higher, the market sensitivity to growth and inflation surprises would increase and there could be fears about a change in the reaction function of the central bank. In the coming months, investors and central banks will scrutinise data in parallel, but the former will react more quickly should inflation stay high.

There is a widely-shared feeling amongst central bankers, analysts and commentators that the increase of inflation in advanced economies should be transitory. However, this assessment is also subject of intense debate, witness the number of speeches and papers devoted to it.

Raphael Bostic, president and CEO of the Federal Reserve Bank of Atlanta, has even added a semantic twist to the discussion. He considers that economists use 'transitory' to describe something that is not persistent, but in doing so, the time dimension is lacking. This is an issue when talking about inflation as a central banker or a financial market investor. He advocates calling the recent increase in inflation as episodic. *"These price changes are tied specifically to the presence of the pandemic and, once the pandemic is behind us, will eventually unwind, by themselves, without necessarily threatening longer-run price stability."*[1] Although there is no reference to timing either, the insistence that price changes will unwind by themselves should be reassuring. Isabel Schnabel, executive board member of the ECB, brings a similarly reassuring message by comparing the current inflationary spike to a sneeze. *"Chances are high that the current episode of above-target inflationary pressures will subside over time."*[2] However, the IMF insists that inflation prospects are surrounded by great uncertainty, with risks being skewed to the upside.[3] Yet, even in a tail-risk scenario and provided that expectations remain well-anchored, headline inflation in advanced economies would go back to trend by early 2024 after peaking at 4.4% by mid-2022.[4]

At the risk of oversimplifying, it looks as if, whatever happens, high inflation should be transitory. This is because one-off price shocks drop out of the annual inflation numbers after twelve months, supply bottlenecks do not last and, if required, central banks will tighten policy to cool down demand. Perhaps we should focus more on the risks associated with inflation staying temporarily high for longer.

Several concerns spring to mind. One, companies that hitherto have been reluctant to raise prices might do so after all, leading to an ever larger number of goods and services with sizeable price increases. This phenomenon is, to some degree, already observable in the US (chart1), although not in the Eurozone (chart2)[5]. Such a broadening could in turn trigger more price increases throughout the value chains. Two, through its impact on company profits and households' purchasing power, this could weigh on investment and personal consumption. Three, higher inflation could fuel demand for higher wages, in particular in the presence of labour market bottlenecks. In the US, the latest CFO Survey shows *"Seventy-four percent of survey participants report that their companies are having difficulty filling open positions. Among these firms, 82 percent are increasing starting wages – by an average of 9.8 percent – in an attempt to fill these vacancies, and 33 percent are implementing or exploring automation to replace workers*."[6] Four, the longer inflation remains high, the greater the risk that it would be considered as permanent rather than transitory. This could cause a gradual unanchoring of inflation expectations, giving an extra boost to price increases and wage demands. Five, market sensitivity to inflation data would increase, even if inflation expectations would still be well-anchored. With the rate of price increases having been above target for some time, there could mounting impatience to see inflation moving below target. This increased sensitivity should lead to higher bond and equity market volatility, which in turn can weigh on the real economy. Six, market-based inflation expectations might increase, causing a jump in bond yields and, possibly, a drop in equity prices. Finally, there could be increasing concern about a sudden change in the message coming from central banks, i.e. a change in their reaction function. This would cause market turbulence with investors trying to interpret the change in the central banks' attitude towards inflation.

In the coming months, more than ever, the data will be scrutinised in order to gauge whether risks are increasing. Investors and central banks will do this in parallel, but the former will react more quickly. They anticipate the possible reaction of the central banks. Herd behaviour can play an important role in guessing the central bank's reaction. Central banks, being afraid of tightening prematurely, will need more data on many more indicators than only prices before they change their mind.

William De Vijlder

1. Raphael Bostic, "*The current inflation episode: have we met our FAIT?*," speech at the Peterson Institute for International Economics, Federal Reserve Bank of Atlanta, 12 October 2021.
2. "*Prospects for inflation: sneezes and breezes*", Welcome address by Isabel Schnabel, Member of the Executive Board of the ECB, at the ECB and Federal Reserve Bank of Cleveland's *"Inflation: Drivers and Dynamics Conference 2021"*, Frankfurt am Main, 7 October 2021
3. IMF, World Economic Outlook, October 2021
4. *"The exercise simulates inflation developments assuming a tail scenario which, according to the model employed here, has less than 0.01 percent probability of materializing. This scenario is marked by strong rises in commodity prices and sectoral inflation dispersion over the next 12 months."* IMF, World Economic Outlook, October 2021, chapter 2.
5. Cells are highlighted when inflation is 2% or more.
6. The survey, published on 14 October, is a collaboration of Duke University's Fuqua School of Business and the Federal Reserve Banks of Richmond and Atlanta.

In the coming months, more than ever, the data will be scrutinised in order to gauge whether inflation risks are increasing. Investors and central banks will do this in parallel, but the former will react more quickly.

UNITED STATES: INFLATION DISPERSION

	All items	All items less Food & Energy (core)	Food	Energy	Energy commodities	Energy services	Shelter	Household furnishings & supplies	Transport. commodities less motor fuel	Medical care commodities	Recreation commodities	Education & communica-tion commodities	Services less energy services	Transportation services	Medical care services	Recreation services	Education & communic. services	Other personal services
Item weight	100.00	79.27	13.25	7.48	4.20	3.28	33.49	3.31	6.44	1.69	1.76	0.50	60.10	5.92	7.14	3.88	6.03	1.64
	year/year % change																	
Sept. 2021	5.4	4.0	4.6	24.8	41.7	8.5	3.2	4.8	14.9	-1.6	3.5	2.6	2.9	4.4	0.9	3.5	1.7	3.4
Aug. 2021	5.3	4.0	3.7	25.0	41.9	8.6	2.8	3.3	17.2	-2.5	3.3	-0.5	2.7	4.6	1.0	3.5	1.3	3.6
Jul. 2021	5.4	4.3	3.4	23.8	41.2	7.2	2.8	3.0	19.8	-2.1	3.2	-0.2	2.9	6.4	0.8	3.7	1.2	3.1
Jun. 2021	5.4	4.5	2.4	24.5	44.2	6.3	2.6	3.4	20.3	-2.2	3.2	-1.2	3.1	10.4	1.0	1.9	2.4	2.5
May 2021	5.0	3.8	2.2	28.5	54.5	6.2	2.2	3.7	13.3	-1.9	3.5	-1.4	2.9	11.2	1.5	0.6	2.2	2.8
Apr. 2021	4.2	3.0	2.4	25.1	47.9	5.4	2.1	3.2	9.2	-1.7	2.9	-2.2	2.5	5.6	2.2	1.8	2.0	3.0
Mar. 2021	2.6	1.6	3.5	13.2	22.0	4.1	1.7	2.8	4.5	-2.4	0.8	-4.9	1.6	-1.6	2.7	1.2	2.0	2.9
Feb. 2021	1.7	1.3	3.6	2.4	1.6	3.2	1.5	2.3	4.2	-2.5	0.3	-2.7	1.3	-4.4	3.0	1.1	2.1	2.2
Jan. 2021	1.4	1.4	3.8	-3.6	-8.7	2.1	1.6	2.4	4.6	-2.3	-0.2	-1.9	1.3	-4.1	2.9	0.3	2.0	2.0
Dec. 2020	1.4	1.6	3.9	-7.0	-15.2	2.6	1.8	2.9	5.0	-2.5	-0.2	-2.5	1.6	-3.5	2.8	1.6	2.3	2.9
Nov. 2020	1.2	1.6	3.7	-9.4	-19.3	2.3	1.9	2.9	5.1	-1.1	-1.0	-4.3	1.7	-3.4	3.2	2.6	2.4	2.4
Oct. 2020	1.2	1.6	3.9	-9.2	-18.1	1.4	2.0	1.9	5.3	-0.8	-1.3	-5.0	1.7	-5.1	3.7	2.6	2.7	2.8

SOURCE: BLS, BNP PARIBAS

EURO AREA: INFLATION DISPERSION

	All-items HICP	Food & non alcoholic beverages	Miscellaneous goods & services	Operation of personal transport equip.	Actual rentals for housing	Furnishings, household equip. & routine	Catering services	Electricity, gas & other fuels	Clothing & footwear	Purchase of vehicles	Communications	Water supply & services for dwelling	Tobacco	Other recreational items & equip.	Out-patient services	Medical products, appliances & equip.	Alcoholic beverages	Recreational & cultural services	Transport services	Newspapers, books & stationery	Audiovisual, photo & IT equip.	Maintenance & repair of dwelling	Accommodation services	Education	Hospital services	Package holidays	Other durables, recreation & culture
Item weight	1000	172.6	99.8	79.7	74.7	67.6	62.6	58.9	53.0	39.4	32.0	30.6	25.5	23.7	21.3	21.1	19.5	18.2	18.2	14.2	13.6	13.3	12.5	10.4	7.6	6.2	3.7
	year/year % change																										
Aug. 2021	3.0	1.9	2.0	11.0	1.1	2.0	1.9	12.5	3.6	3.3	0.1	1.9	3.0	2.1	-0.4	0.7	1.3	1.5	2.5	2.1	0.6	3.4	5.6	0.2	1.6	-0.9	-0.6
Jul. 2021	2.2	1.4	1.9	10.6	1.1	1.3	1.8	11.2	-3.3	3.3	-0.1	1.9	3.0	1.7	-0.4	0.5	1.2	1.7	0.3	2.0	-0.6	3.0	3.0	0.2	1.6	-4.3	-0.7
Jun. 2021	1.9	0.2	1.9	10.2	1.3	1.0	1.7	8.3	1.8	2.4	-1.0	1.6	3.1	1.2	-0.3	0.0	0.2	1.6	-2.0	1.8	-0.9	2.4	-2.2	0.2	2.0	-5.9	-0.6
May 2021	2.0	0.1	1.7	11.1	1.3	0.8	1.4	7.7	0.4	2.1	-1.1	1.6	3.8	1.3	-0.2	0.0	0.2	1.2	-0.9	1.7	-0.7	2.2	-3.2	0.3	1.8	1.5	0.4
Apr. 2021	1.6	0.0	1.7	9.0	1.3	0.7	1.5	6.3	-0.2	1.8	-1.1	1.6	4.4	1.0	-0.7	0.1	0.6	1.4	-2.6	1.8	-0.2	2.1	-2.9	0.1	1.8	-3.8	0.5
Mar. 2021	1.3	0.7	1.7	4.9	1.2	0.8	1.4	2.3	-1.3	1.7	-1.7	1.5	4.3	1.5	-0.5	0.3	0.4	1.2	0.8	1.7	-0.8	1.5	-2.0	0.1	1.8	-1.1	1.4
Feb. 2021	0.9	0.8	1.7	0.0	1.2	0.8	1.3	-1.0	0.7	1.3	-1.3	1.5	5.6	1.6	-0.5	0.3	0.5	1.2	-0.6	1.8	0.5	1.4	-1.7	0.1	1.8	-2.7	1.2
Jan. 2021	0.9	1.0	1.8	-2.6	1.1	1.2	1.5	-1.4	2.5	1.3	-1.3	1.5	5.4	1.5	-0.5	0.4	0.3	1.3	-0.8	1.7	0.1	1.5	-2.1	0.0	1.7	-0.9	1.1
Dec. 2020	-0.3	0.9	1.3	-4.4	1.2	0.1	1.6	-4.0	-2.2	0.4	-2.5	0.9	5.4	0.8	-0.2	-0.1	-0.3	1.5	-3.3	1.6	-0.8	1.1	-1.8	-0.1	2.3	-3.4	0.4
Nov. 2020	-0.3	1.5	1.4	-5.3	1.2	0.0	1.6	-5.0	-0.9	0.6	-2.5	1.0	5.4	0.4	-0.1	-0.2	0.0	1.2	-4.2	1.6	-1.3	1.0	-2.5	-0.1	2.3	-3.8	0.5
Oct. 2020	-0.3	1.7	1.4	-4.9	1.2	0.1	1.7	-5.5	-0.5	0.6	-3.0	0.9	6.0	0.9	0.0	-0.3	-0.2	1.4	-5.2	1.9	-1.8	1.0	-4.2	-0.1	2.2	-3.9	0.5
Sept. 2020	-0.3	1.4	1.3	-4.6	1.2	0.2	1.7	-5.7	-1.4	0.7	-2.2	0.8	6.0	0.8	0.1	-0.2	0.0	1.3	-4.7	2.0	-2.3	1.5	-5.2	1.1	2.1	-3.3	0.4

SOURCE: EUROSTAT, BNP PARIBAS

MARKETS OVERVIEW

OVERVIEW

Week 8-10 21 to 15-10-21				
↗ CAC 40	6 560	▸ 6 728	+2.6	%
↗ S&P 500	4 391	▸ 4 471	+1.8	%
↘ Volatility (VIX)	18.8	▸ 16.3	-2.5	pb
↗ Euribor 3M (%)	-0.55	▸ -0.55	+0.0	bp
↗ Libor $ 3M (%)	0.12	▸ 0.12	+0.3	bp
↘ OAT 10y (%)	0.11	▸ 0.10	-1.1	bp
↘ Bund 10y (%)	-0.15	▸ -0.17	-2.6	bp
↘ US Tr. 10y (%)	1.60	▸ 1.58	-2.9	bp
↗ Euro vs dollar	1.16	▸ 1.16	+0.3	%
↗ Gold (ounce, $)	1 759	▸ 1 773	+0.8	%
↗ Oil (Brent, $)	82.5	▸ 84.1	+2.0	%

MONEY & BOND MARKETS

	Interest Rates		highest 21			lowest 21		
€	ECB	0.00	0.00	at	01/01	0.00	at	01/01
	Eonia	-0.49	-0.47	at	26/01	-0.50	at	01/01
	Euribor 3M	-0.55	-0.53	at	07/05	-0.56	at	06/01
	Euribor 12M	-0.48	-0.47	at	20/04	-0.52	at	02/02
$	FED	0.25	0.25	at	01/01	0.25	at	01/01
	Libor 3M	0.12	0.24	at	13/01	0.11	at	09/09
	Libor 12M	0.28	0.34	at	01/01	0.22	at	06/09
£	BoE	0.10	0.10	at	01/01	0.10	at	01/01
	Libor 3M	0.13	0.14	at	14/10	0.03	at	01/01
	Libor 12M	0.54	0.56	at	14/10	0.07	at	11/01

At 15-10-21

	Yield (%)		highest 21		lowest 21	
€	AVG 5-7y	-0.14	-0.03	at 19/05	-0.46	at 04/01
	Bund 2y	-0.69	-0.64	at 23/06	-0.78	at 04/08
	Bund 10y	-0.17	-0.10	at 12/10	-0.60	at 04/01
	OAT 10y	0.10	0.23	at 17/05	-0.41	at 04/01
	Corp. BBB	0.75	0.81	at 12/10	0.43	at 05/08
$	Treas. 2y	0.40	0.40	at 15/10	0.11	at 05/02
	Treas. 10y	1.58	1.75	at 31/03	0.91	at 01/01
	High Yield	5.03	5.12	at 12/10	4.52	at 29/06
£	gilt. 2y	0.44	0.44	at 11/10	-0.08	at 04/01
	gilt. 10y	1.11	1.19	at 11/10	0.21	at 04/01

At 15-10-21

EXCHANGE RATES

1€ =		highest 21			lowest 21			2021
USD	1.16	1.23	at	06/01	1.15	at	06/10	-5.1%
GBP	0.84	0.91	at	06/01	0.84	at	15/10	-5.8%
CHF	1.07	1.11	at	04/03	1.07	at	14/10	-1.0%
JPY	132.38	133.97	at	28/05	125.22	at	18/01	+4.8%
AUD	1.56	1.64	at	20/08	1.53	at	18/03	-1.4%
CNY	7.46	8.00	at	01/01	7.45	at	11/10	-6.8%
BRL	6.32	6.95	at	03/03	5.88	at	24/06	-0.6%
RUB	82.35	92.47	at	20/04	82.35	at	15/10	-9.0%
INR	87.34	90.39	at	23/04	85.30	at	27/03	-2.3%

At 15-10-21 *Change*

COMMODITIES

Spot price, $		highest 21			lowest 21			2021	2021(€)
Oil, Brent	84.1	84.1	at	14/10	51.2	at	04/01	+62.1%	+70.9%
Gold (ounce)	1 773	1 947	at	05/01	1 682	at	08/03	-6.6%	-1.5%
Metals, LMEX	4 623	4 623	at	14/10	3 415	at	01/01	+35.4%	+42.8%
Copper (ton)	10 538	10 538	at	15/10	7 749	at	01/01	+36.0%	+43.4%
wheat (ton)	238	2.9	at	07/05	223	at	10/09	-3.9%	+1.4%
Corn (ton)	195	2.9	at	07/05	188	at	04/01	+0.4%	+9.2%

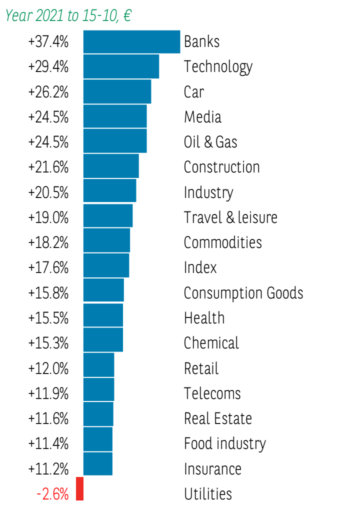
At 15-10-21 *Change*

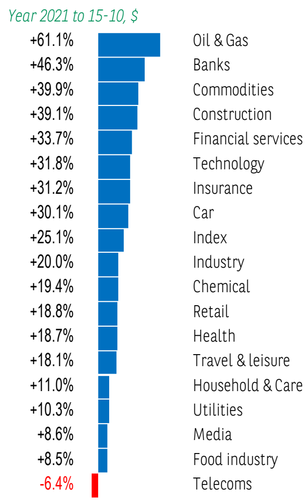
EQUITY INDICES

	Index	highest 21			lowest 21			2021
World								
MSCI World	3 109	3 170	at	06/09	2 662	at	29/01	+15.6%
North America								
S&P500	4 471	4 537	at	02/09	3 701	at	04/01	+19.0%
Europe								
EuroStoxx50	4 183	4 246	at	06/09	3 481	at	29/01	+17.7%
CAC 40	6 728	6 896	at	13/08	5 399	at	29/01	+2.1%
DAX 30	15 587	15 977	at	13/08	13 433	at	29/01	+13.6%
IBEX 35	8 997	9 281	at	14/06	7 758	at	29/01	+1.1%
FTSE100	7 234	7 234	at	15/10	6 407	at	29/01	+1.2%
Asia								
MSCI, loc.	1 155	1 196	at	14/09	1 044	at	06/01	+1.1%
Nikkei	29 069	30 670	at	14/09	27 013	at	20/08	+5.9%
Emerging								
MSCI Emerging ($)	1 284	1 445	at	17/02	1 221	at	20/08	-0.1%
China	93	130	at	17/02	87	at	06/10	-14.4%
India	871	871	at	14/10	659	at	29/01	+32.8%
Brazil	1 625	2 098	at	24/06	1 550	at	07/10	-9.3%
Russia	902	902	at	15/10	647	at	01/02	+30.0%

At 15-10-21 *Change*

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

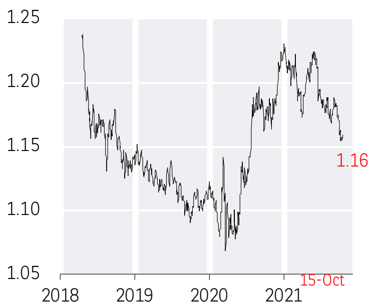




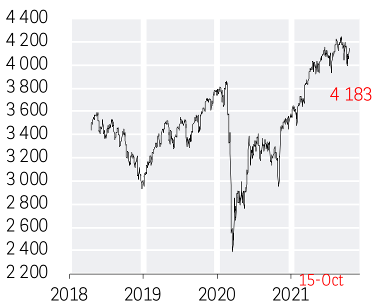
SOURCE: REFINITIV, BNP PARIBAS,

MARKETS OVERVIEW

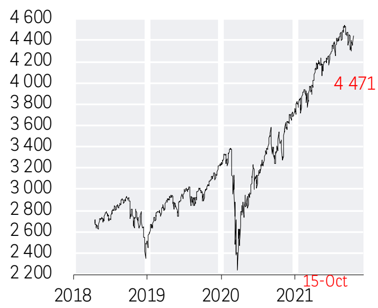
EURO-DOLLAR



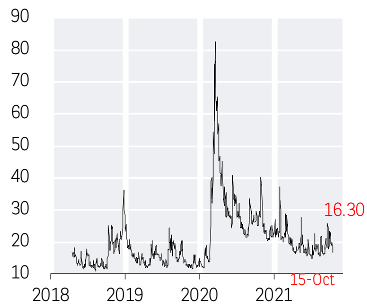
EUROSTOXX50



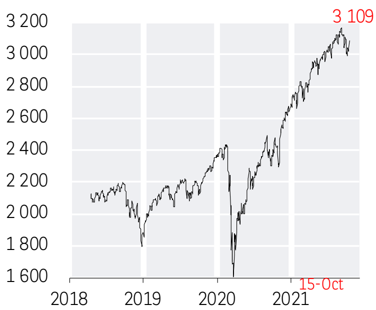
S&P500



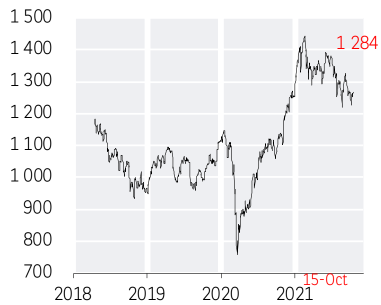
VOLATILITY (VIX, S&P500)



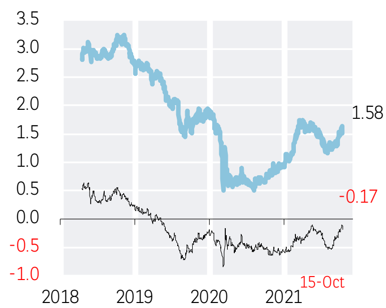
MSCI WORLD (USD)



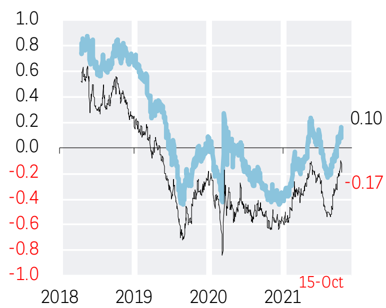
MSCI EMERGING (USD)



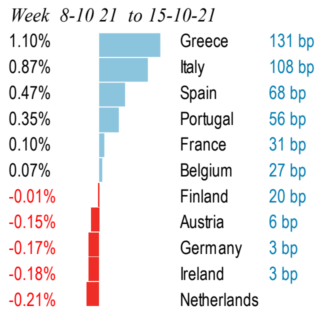
10Y BOND YIELD, TREASURIES VS BUND



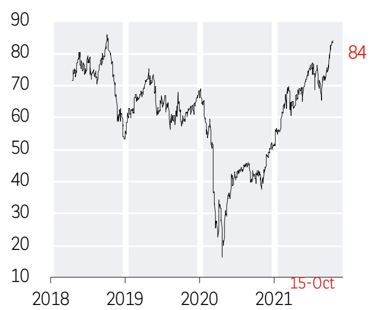
10Y BOND YIELD



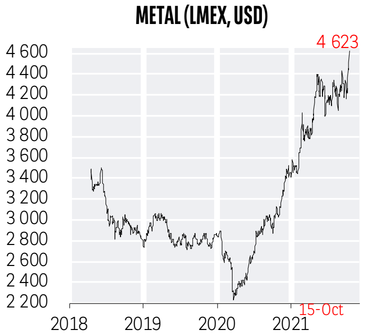
10Y BOND YIELD & SPREADS



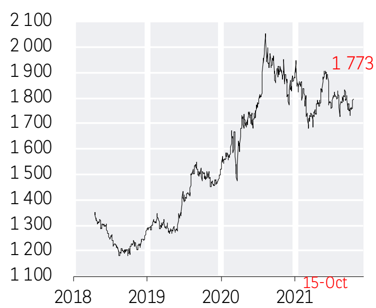
OIL (BRENT, USD)



METAL (LMEX, USD)



GOLD (ONCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

ITALY: OPTIMISM MODERATES

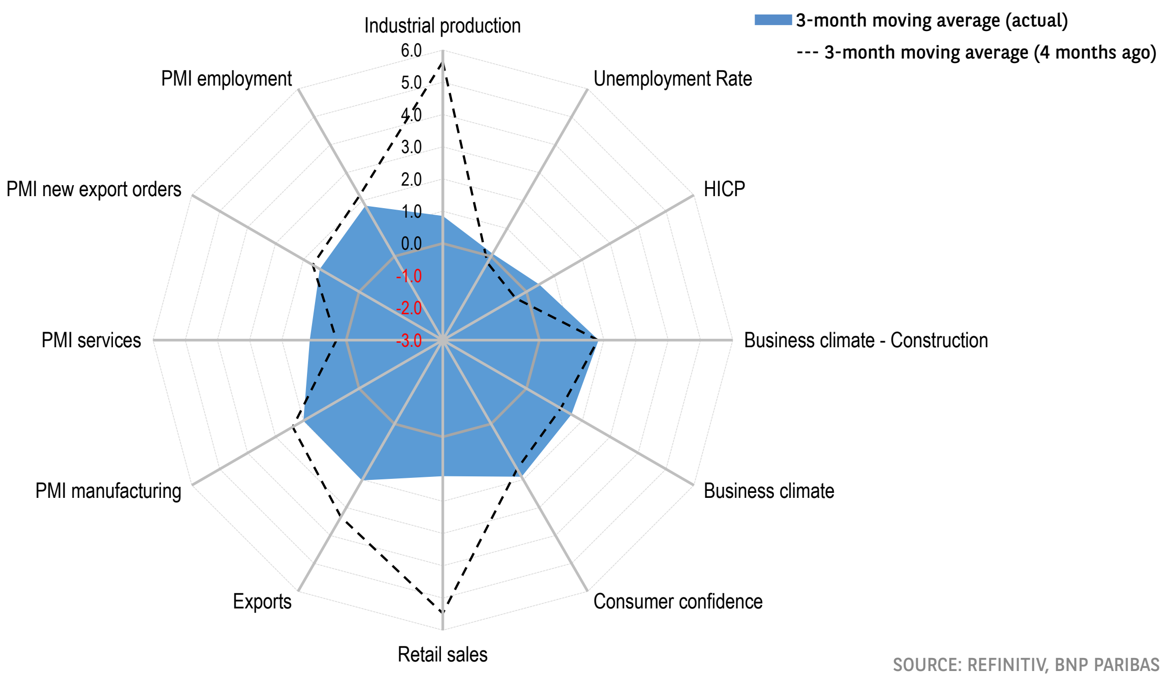
Despite more than 80% of the adult Italian population having received a full vaccination schedule, the government has decided to introduce new constraints to keep the Covid-19 epidemic under control. From 15 October, the use of a health pass (or a recent negative PCR test) has become mandatory for workers. Protests against this measure have erupted in the country's streets in recent days. At the economic level, the impact of this decision is likely to be felt most in the labour market, accentuating labour shortages, and particularly in the transport sector, where between 25% and 30% of workers still do not have the health pass, according to estimates from Confreta, the union for the industry.

Other downside risks will affect economic activity over the short and medium term: despite government aid, rising energy prices will eat into purchasing power and thus household spending. The harmonised index of consumer prices (HICP) shows inflation increased to 2.9% in September; however, price rises have been more limited than in most of Italy's European neighbours so far. Supply problems could also hit consumption of certain goods. New car sales fell sharply in Q3 2021, whilst retail sales were only a touch higher (up 0.5% q/q). The labour market trend remains uncertain too. The participation rate, which dropped swiftly during the lockdowns of 2020, is still significantly lower (by 1 percentage point) than at the end of 2019. This provides context for the drop in the unemployment rate, which nevertheless fell to 9.3% in August.

These risks should not, however, obscure the fact that the recovery in activity was solid in Q2 2021 (+2.7% q/q), and that households remain very optimistic. In September, Istat's consumer confidence indicator reached its highest level since 1988. Confidence in the manufacturing sector (as shown by the PMI report) has stalled somewhat, whilst the mood in the service sector has improved thanks to the ongoing relaxation of health restrictions and constraints on activity. The IMF has raised its growth forecast for 2021 from 4.9% to 5.8%. The figure for 2022 was unchanged at 4.2%.

Guillaume Derrien

ITALY: 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 +6. 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.

SPAIN: FISCAL TIGHTENING CAN WAIT

The sections of our Pulse on industrial production and retail sales deteriorated significantly. This mainly reflects base effects linked to the catch-up in activity in the first half of 2021. In the coming months, household spending could be held back by the rise in energy prices, which shows no sign of slowing down, and possibly also by lengthening delivery times for certain products. Higher spending on energy will result in households cutting back on other areas of expenditures. The negative impact on purchasing power will nevertheless be partly neutralised by government measures introduced in recent weeks (cuts in the VAT rate on energy, a windfall tax on energy company profits). Confidence indices (PMIs, business climate) have fallen slightly over recent weeks, but remain at historically high levels.

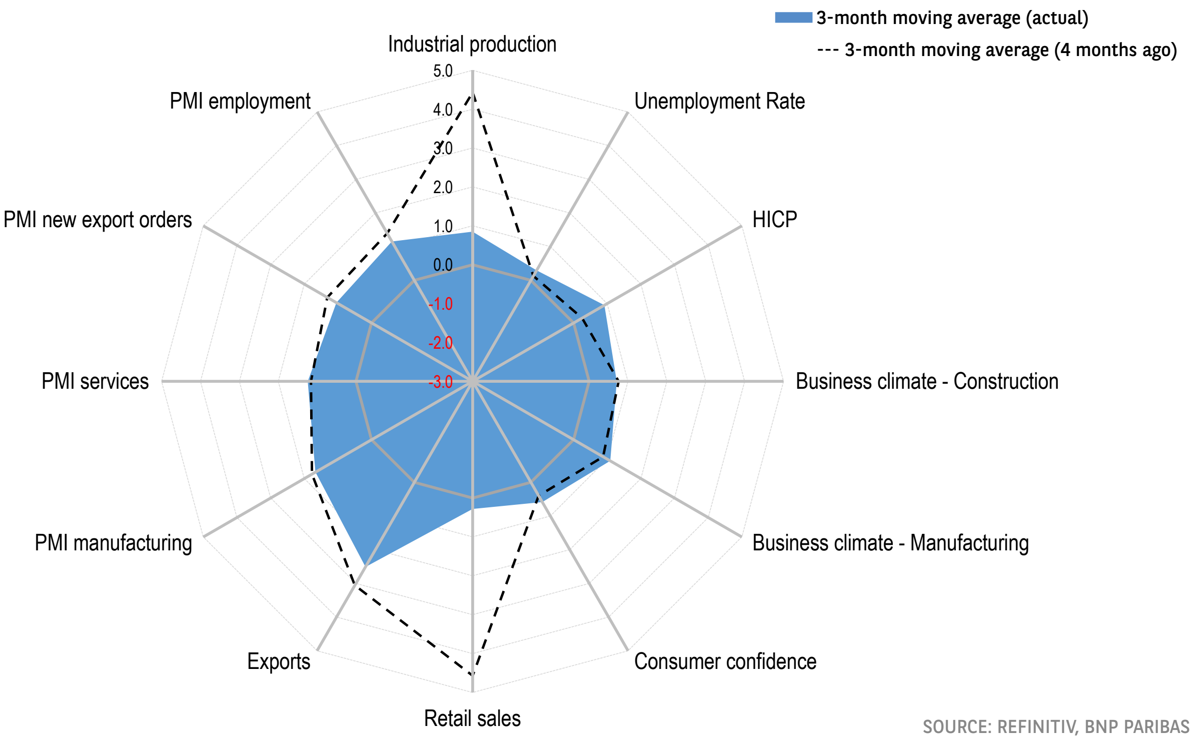
Rising energy costs are pushing inflation upwards, as shown by the expansion of the blue HCPI area on our barometer. Consumer prices continued to rise in September, with an increase of 4.0% y/y, the highest inflation rate for thirteen years.

In its latest World Economic Outlook, the IMF cut its forecast for Spanish growth by 0.5 points to 5.7% in 2021, but revised upwards its estimate for 2022, up by 0.6 points to 6.4%. The significant recovery in the labour market should provide fresh economic impetus over the medium term. According to the Spanish employment agency (SEPE), employment rose further in September (+82,184), taking it above pre-pandemic levels. The unemployment rate fell again in August, to 14.0%, although this is still a very high level.

Although the economic recovery is expected to be robust in 2022, fiscal tightening will be much more modest. The draft budget for 2022, approved last week in the Council of Ministers, will be the biggest in the post-war period, with total public spending at a record level of EUR 459 billion. However, this figure includes EUR 27.6 billion in European aid, which will not therefore affect the deficit. Even so, the deficit will remain substantial in 2022 (5.0% of GDP) and significantly higher than in 2019. Government projections now predict a return below the 3% deficit limit in 2025 at the earliest.

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 +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

JAPAN: RISING ENERGY PRICES ARE CLOUDING OUTLOOK

In the past few months, activity was hampered by the state of emergency in large parts of the country, which affected in particular the services sector. In addition, the manufacturing sector was confronted with supply disruptions, specifically in the car industry. Finally, the substantial base effects related to the pandemic make it difficult to interpret the year-on-year data. The chart suggests a deterioration in Q3, as the blue area (Q3 data) shrinks compared to the area delimited by the hyphenated line (Q2 data). However, the reality is a bit more nuanced.

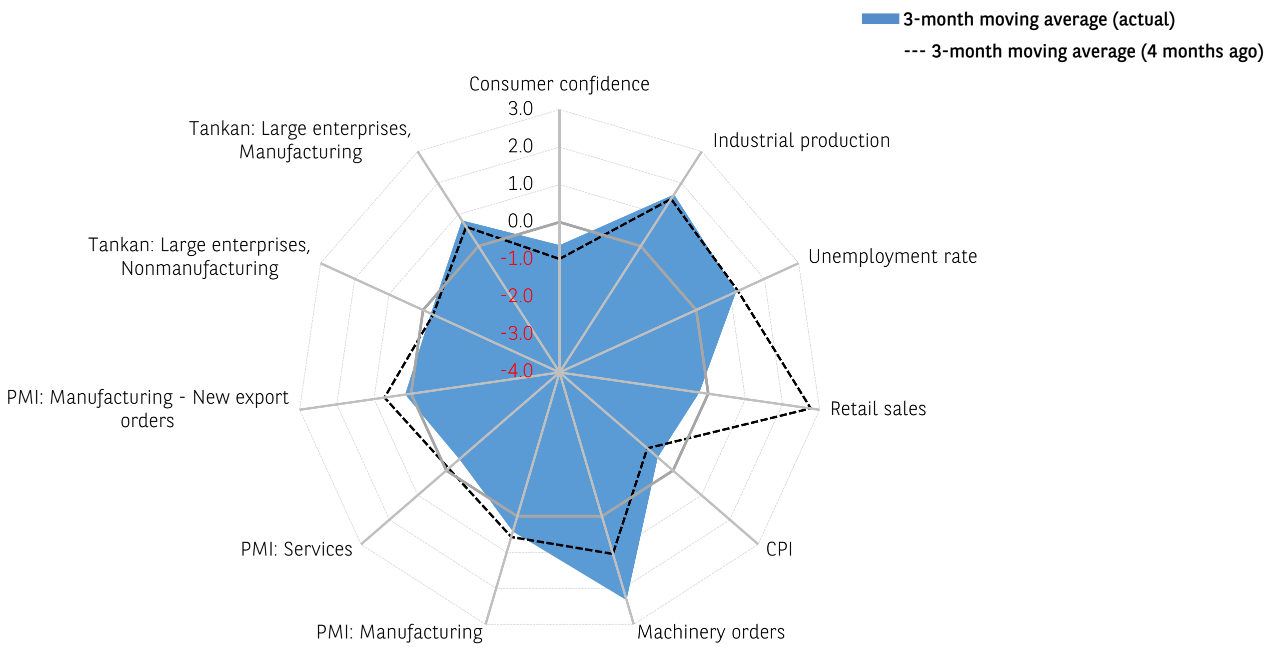
On average, the PMI data for manufacturing came in weaker in Q3. However, a problem with this survey is the sample size: only 400 manufacturers are interviewed each month. By contrast, the ten times larger Tankan survey reported an improvement in business conditions for large and medium-sized enterprises. Only small enterprises reported that conditions had become less favourable. In the non-manufacturing sector, business conditions hardly improved in Q3 according to the Tankan survey and even contracted further according to the PMI survey. This is related to the state of emergency, which was only completely lifted in early October.

Our chart shows a sharp deterioration in retail sales, which is largely due to important base effects and the lockdown restrictions. Nevertheless, consumer confidence is on a rising trend, as employment conditions are improving. According to the Tankan survey, a rising number of enterprises in all industries report staff shortages. The good employment outlook and the end of the state of emergency should boost retail sales in the coming months.

However, headwinds have appeared in the form of rising energy prices. In September, consumer prices in the Ku-area of Tokyo were 0.5% higher from a year earlier, largely driven by higher prices for fuel, light and water (+2.2% y/y and 1.4% m/m). As the country imports almost all of its energy needs, electricity prices could rise much more in the coming weeks. In mid-October, spot prices for peak hour delivery on the Japan Electric Power Exchange hit already a nine-month high. The surge in energy prices is likely to weigh on consumer spending and industrial activity.

Raymond Van Der Putten

JAPAN: 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 -4 and +3. 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

MOBILITY: FOOTFALL DROPS BELOW PRE-COVID LEVELS IN THE MAIN DEVELOPED COUNTRIES

The number of new Covid-19 cases around the world dropped below the symbolic level of 3 million in the week of 7 to 13 October, representing a 7% fall on the previous week. This fall was shared across all regions other than Europe, where case numbers climbed for the third week in a row (chart 1). This increase has mainly been focused on Eastern Europe, the UK and, more recently, Germany. Meanwhile vaccination campaigns have continued to gain ground. Nearly half of the world's population has now received at least one dose of a Covid-19 vaccine. However, there are still substantial disparities between rich nations (70%) and low-income countries (2.5% see Chart 2).

As far as visits to retail and recreation facilities were concerned, we have recently seen an increase in France and Japan and a stabilisation in the UK. By contrast, visit numbers continued to fall in Belgium, Spain, Italy and the USA. It is worth noting that visit numbers are slightly below pre-pandemic levels in the main developed countries as seen in Chart 3 (blue line).

Lastly, the weekly proxy indicator for GDP, relative to its level two years ago, continued to improve in Germany, France and the United States. In Japan, it has been improving for several weeks, despite a slight decline observed lately. In contrast, the indicator's trend has stabilized in Belgium, Italy and Spain in recent weeks, while recently declining in the UK (chart 3 - black line). The OECD Tracker is based on Google Trends resulting from queries on consumption, the labour market, housing, industrial activity as well as uncertainty. The change over a two-year period (y/2y) is calculated to avoid the base effect that would arise from a comparison with 2020 data.

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)

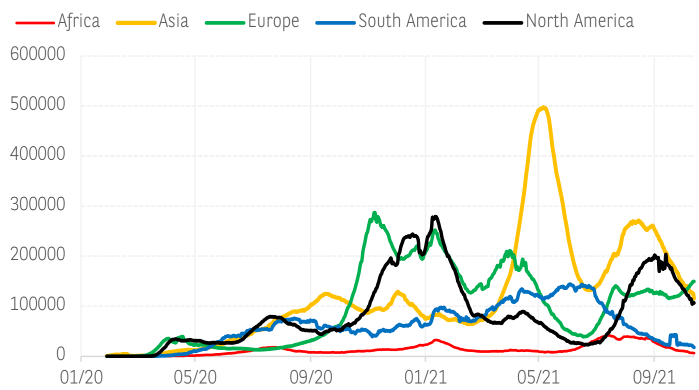


CHART 1 SOURCE: JOHNS-HOPKINS UNIVERSITY (10/14/2021), BNP PARIBAS

SHARE OF PEOPLE WHO RECEIVED AT LEAST ONE DOSE OF VACCINE

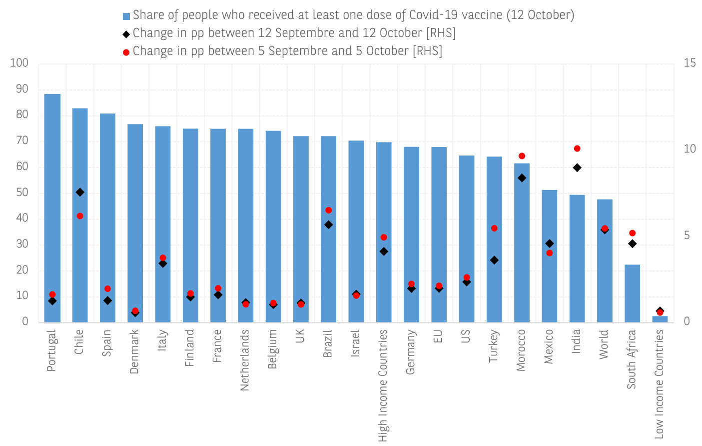
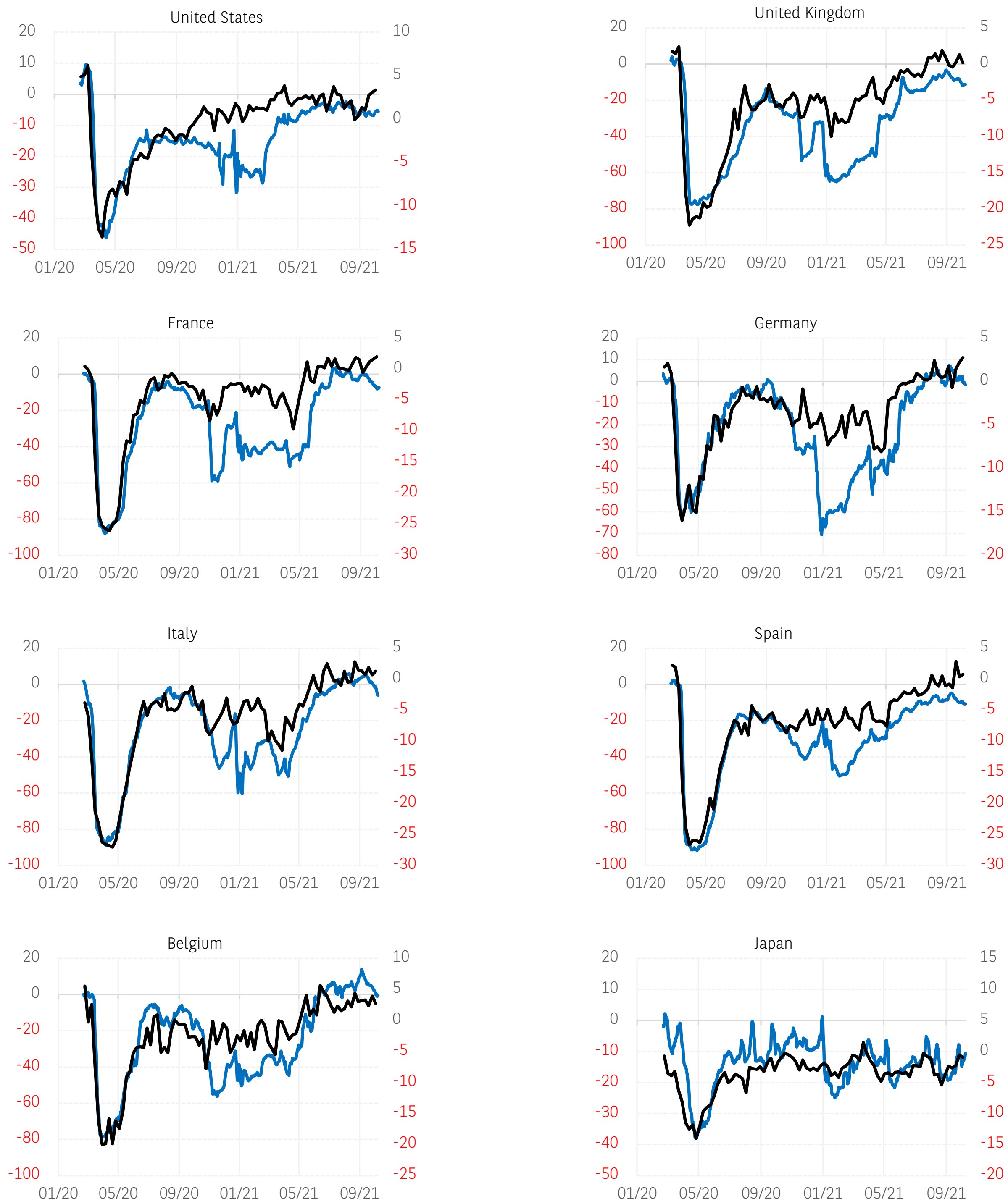


CHART 2 SOURCE: OUR WORLD IN DATA (10/14/2021), BNP PARIBAS

RETAIL AND RECREATION MOBILITY & OECD WEEKLY TRACKER

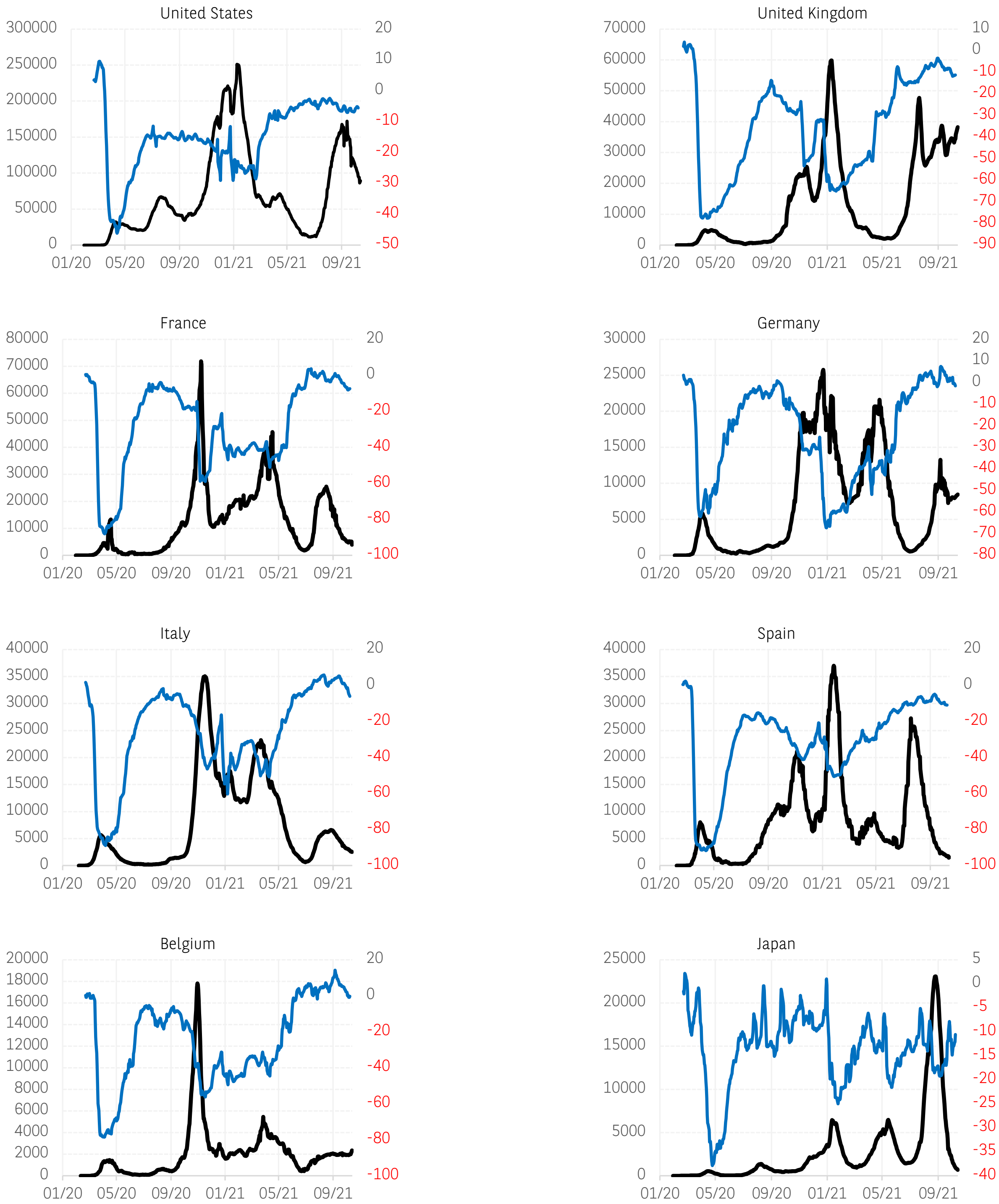
Retail and recreation mobility (7-day moving average, % from baseline*) — OECD Weekly tracker, y/2y GDP growth [RHS]



SOURCE: OECD (10/14/2021), GOOGLE (10/14/2021), 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 (10/14/2021), GOOGLE (10/14/2021), BNP PARIBAS

ECONOMIC SCENARIO

UNITED STATES

The US economy, which roared back through to the spring, has now regained its pre-pandemic level and is set to achieve a growth rate of around 6% in 2021. The outlook for the second part of the year looks less sparkling, however. With the vaccination drive running out of steam, the spread of the delta variant is driving up the number of cases and deaths. Business surveys are not as dazzlingly optimistic. The growth rates anticipated remain above potential, however, and would be sufficient to gradually absorb the job shortage caused by the pandemic, with the unemployment rate expected to move towards the 5% mark by the end of the second half of the year. Given the pressures on supply chains and commodity prices, inflation, currently close to 5%, is unlikely to pull back in the immediate term. Indeed, it is not expected to subside until late 2021 or early 2022.

CHINA

China's post-Covid rebound in industrial production and exports peaked at the start of the year and growth rates have been returning to normal. However, the slowdown has been faster than expected during the summer, and has spread to all sectors. This has resulted from various factors, including: the prudent tightening in fiscal policy and domestic credit conditions, the toughening of regulations in sectors such as real estate and tech, supply-chain constraints in the industry, slower export growth as well as new restrictions imposed to deal with the resurgence of the pandemic. In the short term, the vaccine roll-out should continue to accelerate and the authorities are likely to give greater support to domestic demand through monetary and fiscal measures, while continuing regulatory tightening moves.

EUROZONE

After its strong rebound in Q2 2021, growth is expected to maintain the pace in Q3 (+2.2% QoQ). The various supply constraints mean that growth in the third and fourth quarters is a few tenths below the June forecast, a loss that would be gradually recovered in 2022. The quarterly growth profile should go slightly decrescendo next year. Above all, it would remain well above-trend, supported by the significant monetary and fiscal stimulus, the release of accumulated forced savings and investment needs, to the point where, on an annual average basis, growth would be slightly higher than in 2021 (5.2% after 5%), which distinguishes the Eurozone from the United States and the United Kingdom. The health situation remains a key downside risk. Signs of deteriorating business confidence and mark-ups will also be watched. As for inflation, most of its recent rise is temporary. We expect it to peak in Q4 2021 (nearing 4% in year-on-year terms), before ebbing in 2022. However, it would be at a higher level than before the crisis, as growth strengthens and the reflationary efforts of monetary policy also bear fruit. Our inflation forecasts are above those of the ECB.

FRANCE

With a Q2 2021 growth carry-over of almost 5%, the forecast of 6% growth in 2021 in annual average terms has a solid chance of being met. It is even likely to be exceeded. The Q3 and Q4 prospects, however, look somewhat less positive than they did heading into the summer. Procurement problems, hiring difficulties and rising input prices are holding back the recovery a bit more significantly than expected. The return to normal activity in the tourism, accommodation and catering, culture, entertainment, trade and transports sectors continues to be hampered by the health situation too. In 2022, these various obstacles should disappear, but the support from the mechanical catching-up effect will also fade. Growth should normalize but remain strong, supported by the fiscal impulse.

RATES AND EXCHANGE RATES

In the US, the latest signals from the FOMC show that tapering is coming although this should not be considered as signaling a change in guidance on the policy rate. Nevertheless, we expect that in the second half of next year, the FOMC will hike the federal funds rate given the expected decline in the unemployment rate. Against this background, 10-year Treasury yields should move higher in the remainder of the year and in the first half of 2022, before entering a trading range. The peak in yields should be significantly lower than in previous cycles.

In the eurozone, the ECB will maintain its very accommodative policy centered around its asset purchases and forward guidance, in order to generate a lasting pick-up in inflation towards its target. The outcome of the strategy review has clearly confirmed this. We expect net purchases under the PEPP to stop at the end of March 2022, based on the view that, by then, the pandemic emergency phase will be considered to be behind us. On that occasion, the monthly volume under the traditional asset purchase program should be increased to avoid market disruption. 10-year Bund yields are expected to rise until the first half of 2022 based on the growth and inflation environment. Higher US yields will also play a role. Subsequently, we expect Bunds to stay in a trading range.

Sovereign spreads could widen somewhat in the fourth quarter of this year and early next year on the back of election-related uncertainty. The extent of the widening should be limited, considering ongoing asset purchases by the ECB and the prospect that the ending of net purchases under the PEPP would be accompanied by an increase of the APP.

The Bank of Japan is expected to maintain its current policy stance over the forecast horizon, whilst allowing the 10-year JGB yield to drift higher under the influence of globally rising yields, towards the upper bound of its target range of 0 to 25bp.

We expect the dollar to strengthen versus the euro, driven by widening yield differentials and the growing monetary policy divergence between the Federal Reserve and the ECB. The divergence will also increase between the Fed and the BoJ, which explains our forecast of an appreciation of the dollar versus the yen.

GROWTH & INFLATION

	GDP Growth			Inflation		
%	2021 e	2022 e	2023 e	2021 e	2022 e	2023 e
United-States	6.0	5.3	3.3	4.2	2.8	2.4
Japan	2.1	2.4	1.6	-0.2	0.3	0.5
United-Kingdom	7.0	6.3	2.1	2.3	3.3	2.0
Euro Area	5.0	5.2	2.3	2.4	2.1	1.7
Germany	2.8	5.3	2.4	3.0	2.4	1.9
France	6.3	4.3	2.1	2.0	1.9	1.6
Italy	6.3	5.1	2.8	1.9	2.2	1.4
Spain	6.1	6.4	3.4	2.6	2.2	1.4
China	7.8	5.6	5.4	1.2	2.8	2.5
India*	7.0	11.2	6.2	5.4	4.5	4.3
Brazil	5.0	1.5	2.0	7.8	6.3	3.6
Russia	4.5	3.3	2.6	6.0	5.0	4.1

SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH (E: ESTIMATES & FORECASTS)
*FISCAL YEAR FROM 1ST APRIL OF YEAR N TO MARCH 31ST OF YEAR N+1

INTEREST & EXCHANGE RATES

Interest rates, %

End of period		Q4 2021 e	Q2 2022 e	Q4 2022 e	Q4 2023 e
US	Fed Funds (upper limit)	0.25	0.25	0.50	1.25
	T-Notes 10y	1.70	1.90	2.00	1.90
Ezone	Deposit rate	-0.50	-0.50	-0.50	-0.50
	Bund 10y	-0.10	0.00	-0.10	0.10
	OAT 10y	0.40	0.40	0.20	0.40
	BTP 10y	1.10	1.10	1.00	1.20
	BONO 10y	0.70	0.70	0.70	0.90
UK	Base rate	0.10	0.30	0.50	0.80
	Gilts 10y	0.90	1.10	1.10	1.20
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10
	JGB 10y	0.10	0.20	0.20	0.20

Exchange Rates

End of period		Q4 2021 e	Q2 2022 e	Q4 2022 e	Q4 2023 e
USD	EUR / USD	1.15	1.13	1.12	1.10
	USD / JPY	111	112	114	116
	GBP / USD	1.37	1.36	1.37	1.38
EUR	EUR / GBP	0.84	0.83	0.82	0.80
	EUR / JPY	128	127	128	128

Brent

End of period		Q4 2021 e	Q2 2022 e	Q4 2022 e	Q4 2023 e
Brent	USD/bbl	74	72	73	80

SOURCE: BNP PARIBAS GLOBAL MARKETS (E: ESTIMATES)

LATEST INDICATORS

In the UK, the monthly estimate for real GDP growth recorded a pick-up in August whilst remaining slightly below expectations. On a 3-month moving average basis, growth slowed somewhat versus the previous three months. The pace of job creation improved but less than expected. Banque de France industrial sentiment declined much more in September than anticipated. In Germany, the ZEW dropped, both in terms of the assessment of the current situation and the outlook. Expectations for the Eurozone also deteriorated. August industrial production in the Eurozone declined versus July, virtually in line with expectations. In China, the year over year growth of exports accelerated -the consensus had expected a slowdown- whereas import growth slowed significantly, much more than anticipated. Consumer price inflation hardly changed and remains very low. The gap with producer price inflation is huge (0.7% versus 10.7%). In the US, annual core inflation was stable at 4.0% but the headline number increased further, reaching 5.4%. In September, annual core producer price inflation picked up marginally compared to the August number. Initial jobless claims dropped below 300K, beating expectations. Retail sales control group -a measure which is closely related to private consumption in the national accounts- slowed in September. University of Michigan sentiment disappointed, weakening both in terms of current conditions and expectations. One year inflation expectations edged higher whereas longer-term inflation expectations eased.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	ACTUAL	PREVIOUS
10/11/2021	United Kingdom	Monthly GDP (3M/3M)	Aug	3.0%	2.9%	4.2%
10/11/2021	United Kingdom	Monthly GDP (MoM)	Aug	0.5%	0.4%	-0.1%
10/11/2021	France	Bank of France Ind. Sentiment	Sep	103.0	100.0	103.0
10/12/2021	United Kingdom	Employment Change 3M/3M	Aug	250k	235k	183k
10/12/2021	Germany	ZEW Survey Expectations	Oct	23.5	22.3	26.5
10/12/2021	Germany	ZEW Survey Current Situation	Oct	28.0	21.6	31.9
10/12/2021	Eurozone	ZEW Survey Expectations	Oct	--	21.0	31.1
10/12/2021	United States	NFIB Small Business Optimism	Sep	99.5	99.1	100.1
10/13/2021	Japan	Core Machine Orders MoM	Aug	1.4%	-2.4%	0.9%
10/13/2021	Germany	CPI EU Harmonized YoY	Sep	4.1%	4.1%	4.1%
10/13/2021	Eurozone	Industrial Production SA MoM	Aug	-1.7%	-1.6%	1.4%
10/13/2021	United States	CPI MoM	Sep	0.3%	0.4%	0.3%
10/13/2021	United States	CPI Ex Food and Energy MoM	Sep	0.2%	0.2%	0.1%
10/13/2021	United States	CPI YoY	Sep	5.3%	5.4%	5.3%
10/13/2021	United States	CPI Ex Food and Energy YoY	Sep	4.0%	4.0%	4.0%
10/13/2021	United States	FOMC Meeting Minutes	Sep	--	--	--
10/13/2021	China	Exports YoY CNY	Sep	13.3%	19.9%	15.7%
10/13/2021	China	Imports YoY CNY	Sep	14.6%	10.1%	23.1%
10/14/2021	China	CPI YoY	Sep	0.8%	0.7%	0.8%
10/14/2021	China	PPI YoY	Sep	10.5%	10.7%	9.5%
10/14/2021	United States	Initial Jobless Claims	Oct	320k	293k	329k
10/14/2021	United States	PPI Ex Food and Energy YoY	Sep	7.1%	6.8%	6.7%
10/15/2021	Eurozone	EU27 New Car Registrations	Sep	--	-23.1%	-19.1%
10/15/2021	France	CPI EU Harmonized MoM	Sep	-0.2%	-0.2%	-0.2%
10/15/2021	France	CPI EU Harmonized YoY	Sep	2.7%	2.7%	2.7%
10/15/2021	United States	Retail Sales Advance MoM	Sep	-0.2%	0.7%	0.9%
10/15/2021	United States	Retail Sales Control Group	Sep	0.5%	0.8%	2.6%
10/15/2021	United States	U. of Mich. Sentiment	Oct	73.1	71.4	72.8
10/15/2021	United States	U. of Mich. Current Conditions	Oct	81.3	77.9	80.1
10/15/2021	United States	U. of Mich. Expectations	Oct	69.1	67.2	68.1
10/15/2021	United States	U. of Mich. 1 Yr Inflation	Oct	4.7%	4.8%	4.6%
10/15/2021	United States	U. of Mich. 5-10 Yr Inflation	Oct	--	2.8%	3.0%

SOURCE: BLOOMBERG

CALENDAR: THE WEEK AHEAD

COMING INDICATORS

As usual around this time of the month, several data will be released in China (retail sales, industrial production, fixed assets investments, etc.). In addition, we will also have GDP growth for the third quarter. In the US, we will have several housing market related data (NAHB index, building permits, housing starts) as well as the Philadelphia Fed index, initial jobless claims and the Beige Book of the Fed. We will have consumer price inflation data in the UK, the Eurozone and Japan. In the UK, the CBI business optimism index will be published. We will have business confidence in France and consumer confidence for the Eurozone. Most likely, market attention this week will focus on the flash PMIs.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	PREVIOUS
10/18/2021	China	GDP SA QoQ	3Q	0.40%	1.30%
10/18/2021	China	GDP YoY	3Q	5.00%	7.90%
10/18/2021	China	Retail Sales YoY	Sep	3.50%	2.50%
10/18/2021	China	Retail Sales YTD YoY	Sep	16.30%	18.10%
10/18/2021	China	Industrial Production YoY	Sep	3.90%	5.30%
10/18/2021	China	Industrial Production YTD YoY	Sep	12.20%	13.10%
10/18/2021	China	Fixed Assets Ex Rural YTD YoY	Sep	7.90%	8.90%
10/18/2021	China	Property Investment YTD YoY	Sep	9.50%	10.90%
10/18/2021	China	Surveyed Jobless Rate	Sep	5.10%	5.10%
10/18/2021	United States	NAHB Housing Market Index	Oct	75	76
10/18/21-10/24/21	United Kingdom	CBI Business Optimism	Oct	--	27
10/19/2021	United States	Building Permits MoM	Sep	-3.50%	6.00%
10/19/2021	United States	Housing Starts MoM	Sep	0.00%	3.90%
10/20/2021	United Kingdom	CPIH YoY	Sep	--	3.00%
10/20/2021	United Kingdom	CPI Core YoY	Sep	--	3.10%
10/20/2021	United Kingdom	PPI Output NSA YoY	Sep	--	5.90%
10/20/2021	United Kingdom	PPI Input NSA YoY	Sep	--	11.00%
10/20/2021	Germany	PPI YoY	Sep	--	12.00%
10/20/2021	United Kingdom	House Price Index YoY	Aug	--	8.00%
10/20/2021	Eurozone	CPI YoY	Sep	--	3.00%
10/20/2021	Eurozone	CPI Core YoY	Sep	--	1.90%
10/20/2021	United States	U.S. Federal Reserve Releases Beige Book			
10/21/2021	France	Business Confidence	Oct	--	111
10/21/2021	France	Business Survey Overall Demand	Oct	--	19

SOURCE: BLOOMBERG

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	PREVIOUS
10/21/2021	United States	Initial Jobless Claims	Oct	--	--
10/21/2021	United States	Philadelphia Fed Business Outlook	Oct	24	30.7
10/21/2021	Eurozone	Consumer Confidence	Oct	--	-4
10/22/2021	United Kingdom	GfK Consumer Confidence	Oct	--	-13
10/22/2021	Japan	Natl CPI YoY	Sep	0.20%	-0.40%
10/22/2021	Japan	Natl CPI Ex Fresh Food YoY	Sep	0.10%	0.00%
10/22/2021	Japan	Jibun Bank Japan PMI Mfg	Oct	--	51.5
10/22/2021	Japan	Jibun Bank Japan PMI Services	Oct	--	47.8
10/22/2021	Japan	Jibun Bank Japan PMI Composite	Oct	--	47.9
10/22/2021	United Kingdom	Retail Sales Ex Auto Fuel YoY	Sep	--	-0.90%
10/22/2021	France	Markit France Manufacturing PMI	Oct	--	55
10/22/2021	France	Markit France Services PMI	Oct	--	56.2
10/22/2021	France	Markit France Composite PMI	Oct	--	55.3
10/22/2021	Germany	Markit/BME Germany Manufacturing PMI	Oct	--	58.4
10/22/2021	Germany	Markit Germany Services PMI	Oct	--	56.2
10/22/2021	Germany	Markit/BME Germany Composite PMI	Oct	--	55.5
10/22/2021	Eurozone	ECB Survey of Professional Forecasters			
10/22/2021	Eurozone	Markit Eurozone Manufacturing PMI	Oct	--	58.6
10/22/2021	Eurozone	Markit Eurozone Services PMI	Oct	--	56.4
10/22/2021	Eurozone	Markit Eurozone Composite PMI	Oct	--	56.2
10/22/2021	United Kingdom	Markit UK PMI Manufacturing SA	Oct	--	57.1
10/22/2021	United Kingdom	Markit/CIPS UK Services PMI	Oct	--	55.4
10/22/2021	United Kingdom	Markit/CIPS UK Composite PMI	Oct	--	54.9
10/22/2021	United States	Markit US Manufacturing PMI	Oct	--	60.7
10/22/2021	United States	Markit US Services PMI	Oct	--	54.9
10/22/2021	United States	Markit US Composite PMI	Oct	--	55

SOURCE: BLOOMBERG

FURTHER READING

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4th quarter 2021 issue	EcoEmerging	13 October 2021
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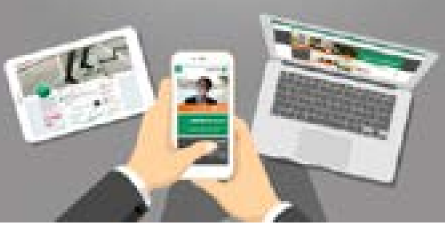

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