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ECONOMIC RESEARCH

BNP PARIBAS

The bank
for a changing
world

EDITORIAL

THE MONETARY CYCLE: FROM PANIC TO PERSEVERANCE TO PATIENCE

In recent months, the huge and rising gap between observed and target inflation has confronted central banks with an urgency to act. It could be called the panic phase of the tightening cycle. What followed was a swift succession of significant rate increases. Tightening was frontloaded, rather than gradual, to avoid an unanchoring of inflation expectations. This perseverance phase will be followed by a long wait-and-see attitude once the terminal rate -the cyclical peak of the policy rate- will have been reached. During this patience phase of the monetary cycle, the central bank will monitor how inflation evolves. With the risk of further rate hikes having declined, the government bond market should stabilize, which can have positive spillovers to other asset classes. Likewise, the real economy may also sigh a breath of relief, given the reduction in interest rate risk, unless demand and activity would in the meantime have suffered a lot from higher interest rates.

The assessment of the inflation outlook by central banks, international organizations and private sector economists has changed radically over the past twelve months as it became clear that the rapid increase in prices would be persistent rather than transitory.

Inflation reflects an imbalance between demand and supply, the former being bigger than the latter -i.e. demand-side inflation- or a situation of significant increases in the price of key products, such as oil, or even services. In that case on speaks of supply-side inflation.

The eruption of the Covid-19 pandemic, the policy reactions and, since the end of February this year, the war in Ukraine, have created a unique sequence and combination of events in the demand and supply side of the economy, with major repercussions in terms of inflation (*figure 1*). After a plunge in demand due to lockdown, pent-up demand was unleashed. Income transfers from governments supported the dynamism of consumer spending, in particular in the US. Spending shifted between goods (bought on-line during lockdown) and services (post-lockdown). All these factors had a big influence on the evolution of prices.

On the supply side, disruption of global supply chains, reallocation of labour between sectors -sometimes causing major staff shortages, such as in hotels, restaurants and the travel industry- and insufficient investment in production capacity in the past in certain sectors also impacted inflation.

The war in Ukraine made the problem worse. For central banks, the huge and rising gap between observed and target inflation eventually created an urgency to act. This can be considered as the panic phase of the tightening cycle (*chart 2*). In a matter of months, guidance was first changed to signal that rate increases were coming and then dropped altogether, considering the impossibility to determine how much policy would need to be tightened.

What followed was a swift succession of significant rate increases (frontloading), rather than the gradualist, stair step approach that was followed during the previous cycle in the US (*figure 3*). When inflation is persistently very high and nominal policy rates very low, there is a genuine risk of unanchoring of inflations expectations (*figure 48*). Under a gradualist approach, the initial rate increases may reduce this risk somewhat but it may very well increase again thereafter when it appears that the small rate increases have no or hardly any impact on inflation.

Frontloaded tightening on the other hand should lead to a lasting reduction in the risk of inflation expectations spinning out of control. However, the aggressiveness of this approach leads to mounting concern about a hard landing, but during this perseverance phase, this does not stop central banks from pushing the brakes ever harder.

ELEVATED INFLATION, DRIVEN BY DEMAND AND SUPPLY FACTORS

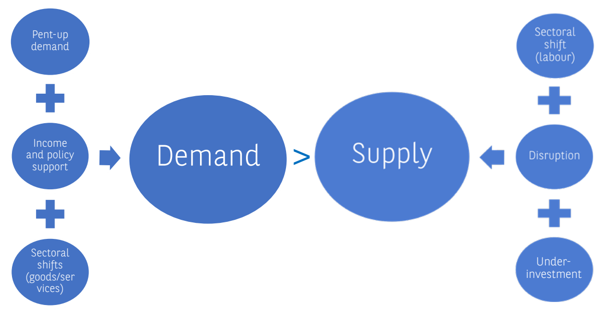


FIGURE 1 SOURCE: BNP PARIBAS

As policy becomes tighter and tighter, the focus of households, firms and investors next year will gradually shift. As concerns about upside risks to inflation start to wane, fears about downside risks to growth will start to dominate.

Not doing enough in the short run would imply that bringing inflation back to target would be even more difficult and costly. Frontloading implies that the cyclical peak in the policy rate -the terminal rate- will be reached earlier than under a gradualist approach.

During the patience phase of the monetary cycle, the central bank, having done enough of the tightening, can afford to wait and see how the data evolve. With the risk of further rate hikes having declined, fixed income investors will step up their investment in long-dated bonds, to lock in what they consider to be attractive yields. The stabilization of the bond market can have positive spillovers to other asset classes. Likewise, when the central bank is in patient mode, the real economy may also sigh a breath of relief, given the reduction in interest rate risk. Central banks move to a wait and see mode because, one, they hope that the cumulative tightening will be sufficient to drive down inflation to target and, two, because they become concerned about an overkill (*figure 5*). As policy becomes tighter and tighter, their pay-off function changes: further hikes may do little to change the inflation dynamics but imply greater risks of a severe contraction of activity. For these reasons, the focus of households, firms and investors next year will gradually shift. As concerns about upside risks to inflation start to wane, fears about downside risks to growth will start to dominate.

William De Vijlder

THE PANIC PHASE OF THE TIGHTENING CYCLE

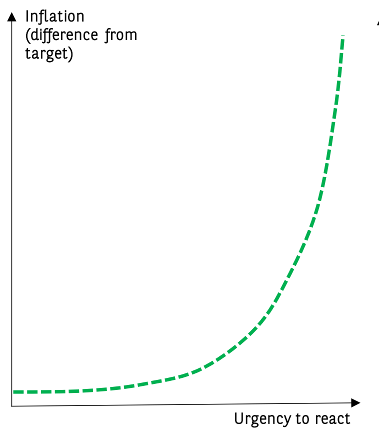


FIGURE 2 SOURCE: BNP PARIBAS

US FEDERAL FUNDS

FIGURE 3 SOURCE: FEDERAL RESERVE BANK OF ST. LOUIS, BNP PARIBAS

FRONTLOADING AND GRADUAL TIGHTENING

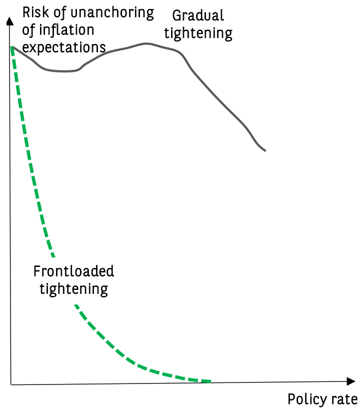


FIGURE 4 SOURCE: BNP PARIBAS

VALUE OF WAITING

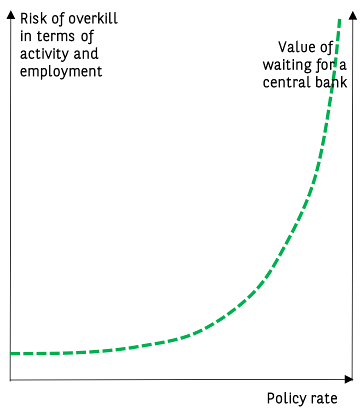


FIGURE 5 SOURCE: BNP PARIBAS

MARKETS OVERVIEW

OVERVIEW

Semaine du 9-9-22 au 16-9-22

↘ CAC 40	6 212	▸	6 077	-2.2	%
↘ S&P 500	4 067	▸	3 873	-4.8	%
↗ Volatilité (VIX)	22.8	▸	26.3	+3.5	pb
↗ Euribor 3m (%)	0.93	▸	1.06	+12.9	pb
↗ Libor $ 3m (%)	3.25	▸	3.57	+32.0	pb
↗ OAT 10a (%)	2.28	▸	2.32	+3.6	pb
↗ Bund 10a (%)	1.70	▸	1.77	+6.5	pb
↗ US Tr. 10a (%)	3.32	▸	3.45	+12.6	pb
↘ Euro vs dollar	1.00	▸	1.00	-0.1	%
↘ Or (once, $)	1 714	▸	1 675	-2.3	%
↘ Pétrole (Brent, $)	92.9	▸	91.4	-1.7	%

MONEY & BOND MARKETS

Interest Rates		highest 22			lowest 22		
€ ECB	1.25	1.25	at	14/09	0.00	at	03/01
Eonia	-0.51	-0.51	at	03/01	-0.51	at	03/01
Euribor 3M	1.06	1.06	at	16/09	-0.58	at	05/01
Euribor 12M	2.26	2.26	at	16/09	-0.50	at	05/01
$ FED	2.50	2.50	at	28/07	0.25	at	03/01
Libor 3M	3.57	3.57	at	16/09	0.21	at	03/01
Libor 12M	4.67	4.67	at	16/09	0.58	at	03/01
£ BoE	1.75	1.75	at	04/08	0.25	at	03/01
Libor 3M	2.76	2.76	at	16/09	0.26	at	03/01
Libor 12M	0.81	0.81	at	03/01	0.81	at	03/01

At 16-9-22

Yield (%)		highest 22			lowest 22		
€ AVG 5-7y	2.22	2.22	at	16/09	-0.04	at	03/01
Bund 2y	1.41	1.41	at	16/09	-0.83	at	04/03
Bund 10y	1.77	1.77	at	16/09	-0.14	at	24/01
OAT 10y	2.32	2.32	at	16/09	0.15	at	04/01
Corp. BBB	4.15	4.15	at	16/09	0.90	at	05/01
$ Treas. 2y	3.90	3.92	at	15/09	0.70	at	04/01
Treas. 10y	3.45	3.48	at	14/06	1.63	at	03/01
High Yield	8.96	9.09	at	30/06	5.07	at	03/01
£ gilt. 2y	3.09	3.17	at	05/09	0.69	at	03/01
gilt. 10y	3.13	3.18	at	13/09	0.97	at	03/01

At 16-9-22

EXCHANGE RATES

1€ =		highest 22		lowest 22			2022
USD	1.00	1.15	at 10/02	0.99	at	06/09	-11.8%
GBP	0.88	0.88	at 16/09	0.83	at	14/04	+4.5%
CHF	0.97	1.06	at 10/02	0.96	at	14/09	-6.9%
JPY	143.38	144.46	at 13/09	125.37	at	04/03	+9.5%
AUD	1.50	1.62	at 04/02	1.43	at	25/08	-4.4%
CNY	7.04	7.29	at 10/02	6.75	at	14/07	-2.8%
BRL	5.29	6.44	at 06/01	5.01	at	21/04	-16.5%
RUB	60.71	164.76	at 07/03	56.01	at	29/06	-28.8%
INR	79.99	85.96	at 11/02	79.05	at	01/09	-5.4%

At 16-9-22 *Change*

COMMODITIES

Spot price, $		highest 22			lowest 22			2022	2022(€)
Oil, Brent	91.4	128.2	at	08/03	79.0	at	03/01	+16.6%	+32.1%
Gold (ounce)	1 675	2 056	at	08/03	1 667	at	15/09	-8.1%	+4.2%
Metals, LMEX	3 689	5 506	at	07/03	3 473	at	14/07	-18.1%	-7.1%
Copper (ton)	7 869	10 702	at	04/03	7 160	at	14/07	-19.2%	-8.4%
wheat (ton)	311	4.7	at	17/05	276	at	18/08	+30.9%	+48.4%
Corn (ton)	263	3.2	at	28/06	226	at	03/01	+1.5%	+30.6%

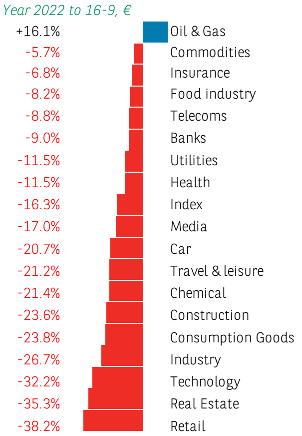
At 16-9-22 *Change*

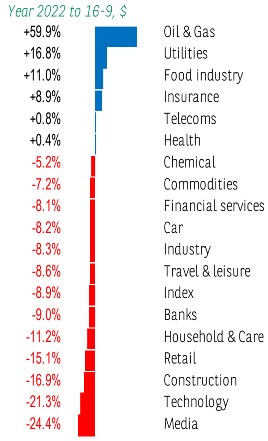
EQUITY INDICES

	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	3 873	4 797	at	03/01	3 667	at	16/06	-18.7%
Europe								
EuroStoxx50	3 500	4 392	at	05/01	3 360	at	05/07	-18.6%
CAC 40	6 077	7 376	at	05/01	5 795	at	05/07	-1.5%
DAX 30	12 741	16 272	at	05/01	12 401	at	05/07	-19.8%
IBEX 35	7 985	8 934	at	27/05	7 645	at	07/03	-0.8%
FTSE100	7 237	7 672	at	10/02	6 959	at	07/03	-0.2%
Asia								
MSCI, loc.	1 070	1 165	at	05/01	1 024	at	08/03	-0.6%
Nikkei	27 568	29 332	at	05/01	24 718	at	09/03	-4.3%
Emerging								
MSCI Emerging ($)	944	1 267	at	12/01	944	at	16/09	-2.3%
China	61	86	at	20/01	59	at	15/03	-25.0%
India	792	891	at	13/01	699	at	17/06	+0.6%
Brazil	1 486	2 003	at	04/04	1 311	at	14/07	-2.0%

At 16-9-22 *Change*

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

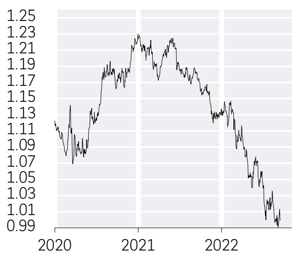




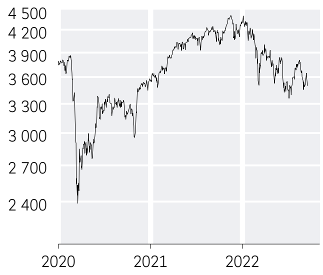
SOURCE: REFINITIV, BNP PARIBAS,

MARKETS OVERVIEW

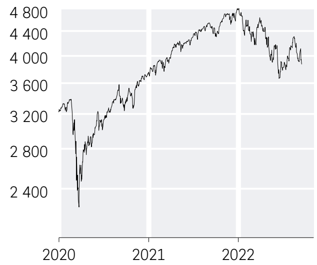
EURO-DOLLAR



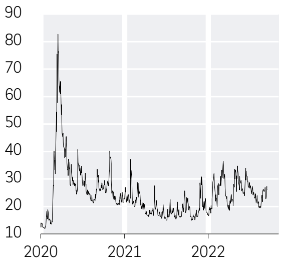
EUROSTOXX50



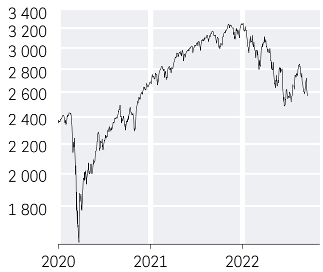
S&P500



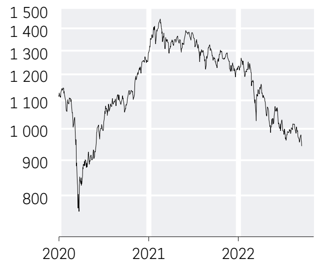
VOLATILITY (VIX, S&P500)



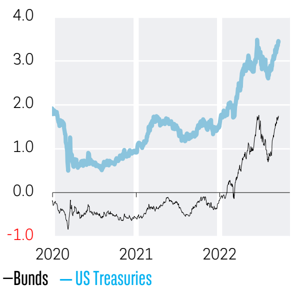
MSCI WORLD (USD)



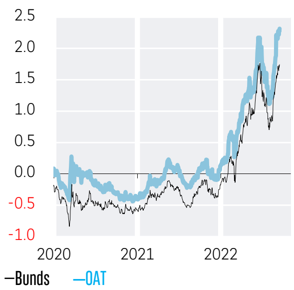
MSCI EMERGING (USD)



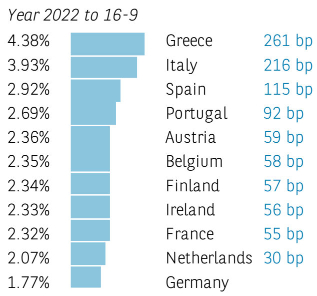
10Y BOND YIELD, TREASURIES VS BUND



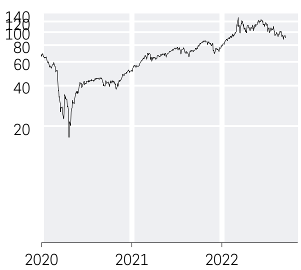
10Y BOND YIELD



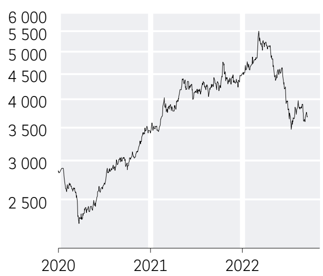
10Y BOND YIELD & SPREADS



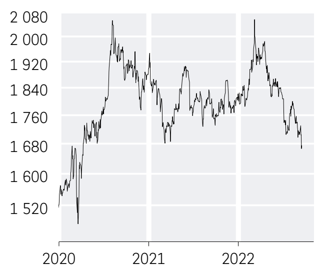
OIL (BRENT, USD)



METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

ECONOMIC PULSE

CHINA: A BRIEF RESPITE IN AUGUST

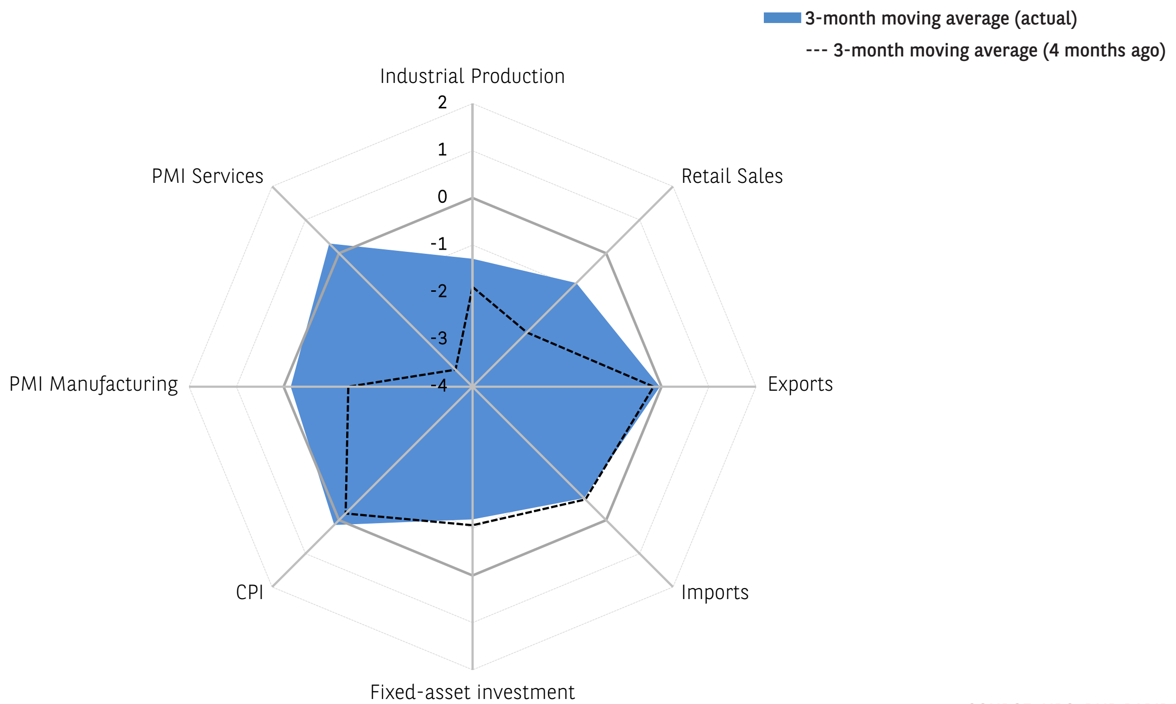
Our Pulse shows an improvement in Chinese economic conditions over the period June–August 2022 compared to the previous three months (widening of the blue zone compared to the dotted zone). In fact, the very strict lockdown measures imposed in the spring (in Shanghai in particular) started to be lifted at the end of May, allowing activity to resume.

The acceleration in economic growth has remained very gradual. However, it surprised positively in August, both in industry (+4.2% y/y after +3.8% in July and +0.6% in Q2 2022) and in services (+1.8% y/y after +0.6% in July and -3.3% in Q2). This was in spite of many headwinds: the average level of mobility restrictions increased again, the drop in hydroelectricity production caused by drought led to rationing in several provinces, and export growth began to slow down (+7% y/y in August after +17% on average for the previous three months). The improvement in August was mainly the result of supportive government policies, with particularly visible effects in the automotive sector (whose sales were encouraged by tax measures) and public investment. Growth in domestic investment thus strengthened slightly in August and stood at +5.8% y/y in the first eight months of 2022 (in nominal terms), driven by investment in infrastructure. The decline in real estate investment continued and growth in manufacturing investment accelerated slightly (+10%).

However, the growth recovery is expected to come to a halt again in September. Firstly, the external environment continues to deteriorate, weighing on export performance. Secondly, the zero Covid policy continues to be very strictly enforced. The lockdowns imposed in Chengdu and Shenzhen in the first half of September were relatively temporary but strict, penalising retail sales and activity in services. Finally, the severe crisis in the real estate and construction sectors continues, exacerbating the loss of confidence among households and investors.

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

GERMANY: PUT TO THE TEST

With Gazprom announcing on 2 September that gas deliveries via NordStream1 would be interrupted until further notice due to alleged oil leaks discovered during maintenance work, the increase in deliveries promised by the Russian company via other pipelines (such as those crossing Ukraine) will only marginally compensate for the shutdown of NordStream1. The likelihood of power cuts this winter is increasing even though gas inventories are expected to be replenished in early November.

At the same time, consumer prices are continuing to accelerate in Germany. Inflation, as measured by Destatis, was +7.9% year-on-year in August. The energy shock has very quickly spread to goods, which continue to show rising prices (+14.7% y/y) while price movements in the cost of services have been more moderate (+2.2% y/y).

Despite the significant momentum in prices, remuneration paid to employees (including wages and bonuses) slowed in nominal terms during the 2nd quarter (+2.9% y/y following +4% y/y in the 1st quarter) due to a decrease in the variable component, resulting in a very sharp drop in earnings in real terms (-4.4% y/y following -1.8% y/y). Faced with such a loss in purchasing power, the government of Olaf Scholz announced a new package of measures worth 65 billion euros (or 1.8% of GDP). With total expenditure exceeding 3.5% of its GDP, Germany is now one of the most interventionist countries in Europe against the backdrop of the inflationary shock and the energy crisis.

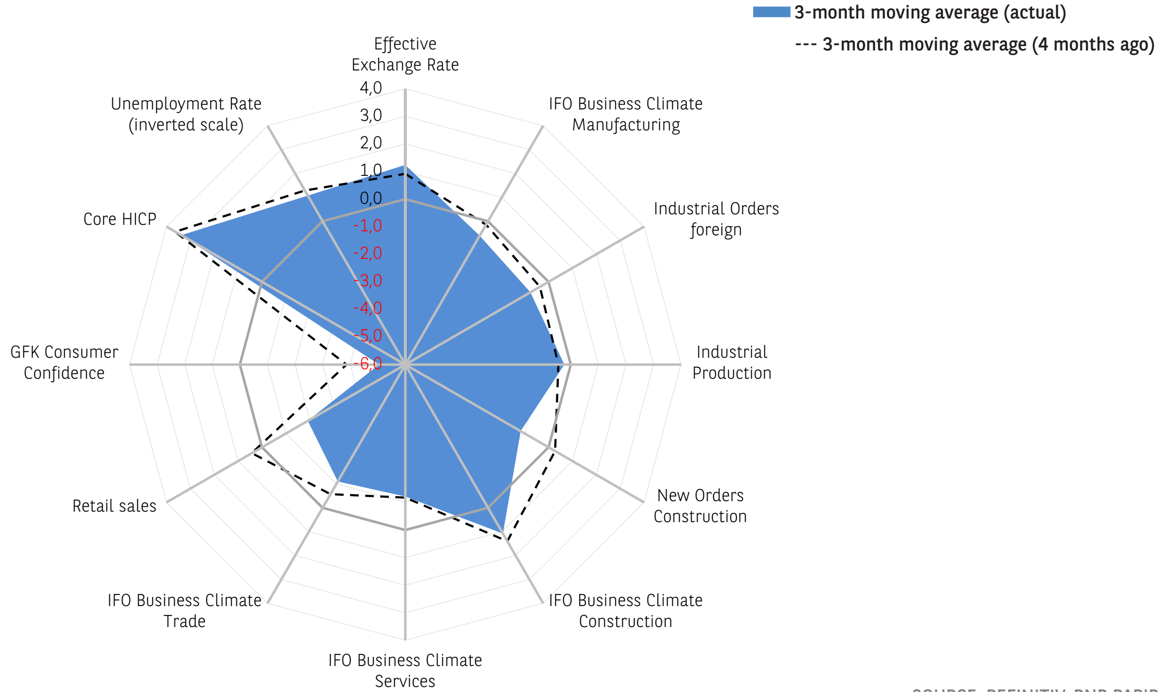
Included in this new raft of measures are energy payments of 300 euros for pensioners and 200 euros for students. The government will also reduce VAT on gas and apply reduced prices on basic electricity consumption. Finally, the subsidy for rail transport will be extended and expanded (the monthly rate is likely to be raised to 49 euros instead of 9 euros). Initial estimates show that the price cap would reduce total inflation year-on-year by around 0.5 points.

In addition there are increasingly evident signs of a slowdown in production. Industrial production lost ground in July (-0.3% m/m) and fell 1.1% over one year after having been stable in June. The decline is even more marked in the manufacturing industry (-1% m/m; -1.4 over one year), which is still 5% below its pre-crisis level. It is the energy-intensive industries that have seen the biggest falls in production (paper, chemicals, automotive). New orders for the industry have also fallen (-1.1% m/m). While orders from countries outside the euro zone have rebounded strongly (+6.4% m/m), domestic orders fell back sharply (-4.5% m/m), a sign that German domestic demand is suffering. The signals emanating from the PMIs for August show that activity is likely to continue to deteriorate (-1.2 pts m/m for the composite to 46.9). The decline is apparent in the services industry, where the PMI lost 2 pts over one month (to 47.7) and in industry where the production capacity utilisation rate continues to deteriorate (-1.8 pts m/m to 54.3). The analysts surveyed in early September by the ZEW have revised their assessment of the current situation downwards (-1.5 pts m/m to 55.3) as well as their expectations for the next six months (-1.8 pts m/m to 55.3).

Finally, after a significant improvement in the trade surplus in June, this fell in July (falling from 6.2 bn euros to 5.4 bn euros), impacted by the effect of a decline that was more marked in exports (-2.1% m/m) than in imports (-1.5% m/m). The Kiel Institute estimates that exports have continued to slump in August (-0.7% m/m), further reducing the trade surplus to just 3.6 bn euros.

Anthony Morlet-Lavidalie

GERMANY: 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 -6 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

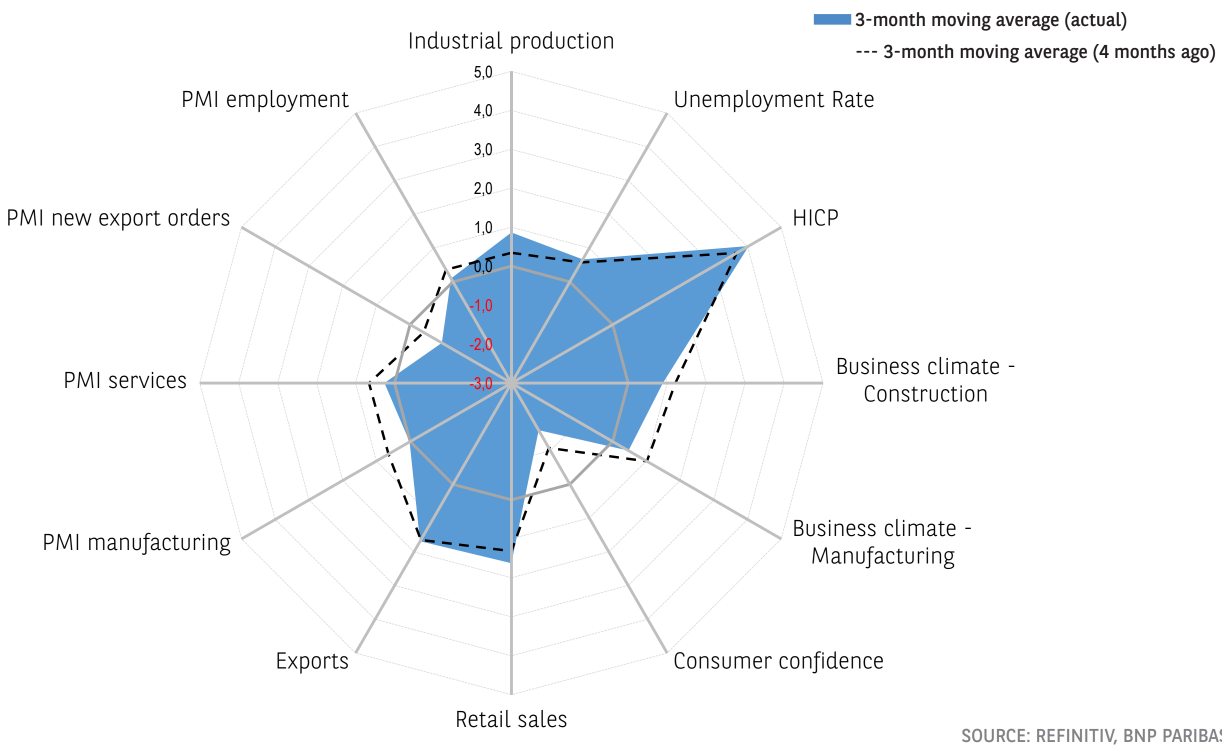
SPAIN : INFLATION PERSISTS

Inflation in Spain shows no signs of abating. Consumer price inflation remained above 10% y/y in August, at 10.5% (national measure). Although slightly lower when compared to July (10.8% y/y), this decline was mainly due to a fall in private transport costs (-3.5% over one month), the result of lower fuel prices at the pump. Conversely, the increase in food prices (and non-alcoholic beverages) accelerated, by 0.3 of a point to 13.8% y/y, with increases seen in dairy products, bread, and corn. The underlying measure (which excludes energy and perishable foods) also rose, from 6.1% y/y to 6.4% y/y. Prices also continue to be very dynamic in the property sector. According to the INE, house prices are up by 2.0% q/q in Q2 2022 and by 8.0% over the last twelve months. The gap compared to the 2007 peak is still significant (prices are still around 7% lower) but much ground has already been covered: at the low point of 2013, prices had fallen by 32% compared to the 2007 peak.

The adverse effects of inflation on business activity should be particularly apparent from Q4 2022, with the economy still benefiting in the third quarter from significant support from sources such as tourism. In particular, the level of job creation has still been unexpectedly positive up to this point. According to the Spanish employment agency (SEPE), the number of workers registered with the social security system rose again in August (+62,136), with gains generalised across all three major sectors: services, industry and construction. The unemployment rate was stable in July, at 12.6%. However, this positive momentum could be derailed. Opinion surveys are becoming less positive, both the European Commission survey (which shows consumers' view of the 12-month unemployment outlook to be at its highest for 18 months), and PMI surveys (the composite employment index is also at its lowest since the first quarter of 2021, at 50.4). Spanish manufacturers are also suffering from the slowdown experienced by their European neighbours, as illustrated by the PMI exports index which is deeply in contractionary territory (45.4 in August).

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

COVID-19: THE PANDEMIC CONTINUES TO SLOW DOWN SIGNIFICANTLY ACROSS THE WORLD

The downward trend in the number of new COVID-19 cases has continued worldwide for the seventh consecutive week. 3.6 million cases were reported between 6 and 12 September, down 16% from the previous week (Chart 1). Overall, the situation is continuing to improve noticeably in South America (-33%), North America (-20%) and Asia (-18%), but it has stabilised in Europe after falling for eight weeks. In Africa, the number of cases fell again (-12%) after rising slightly during the previous week. Meanwhile, vaccination campaigns are continuing to progress worldwide, but at a much slower pace. Sixty-eight percent of the world's population has received at least one dose of a vaccine (Chart 2).

At the same time, footfall in shopping and leisure facilities in Belgium, Italy, France and Germany remains at its pre-pandemic level, while it is still below its pre-COVID level in the other countries in our sample (Spain, Japan, United States and United Kingdom). The recent dip in the UK is probably linked to the ceremonial events marking the death of Queen Elizabeth II (Chart 3, blue curve).

The weekly GDP proxy indicator is continuing to recover in the United States and Japan, while it is remaining stable in Italy and Belgium. Downward trends are continuing in France, Germany and the United Kingdom, while Spain has enjoyed a slight increase very recently (Chart 3, black curve). This indicator is produced by the OECD using Google Trends data from searches relating to consumption, the labour market, real estate, industrial activity and uncertainty. The indicator shown here is calculated on a rolling basis over one year.

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)

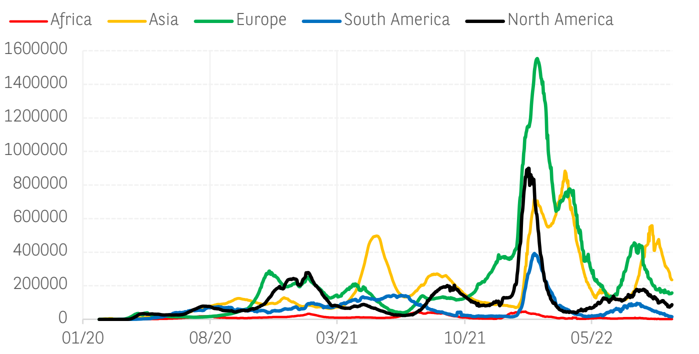


CHART 1 SOURCE: JOHNS-HOPKINS UNIVERSITY (09/15/2022), BNP PARIBAS

SHARE OF PEOPLE WHO RECEIVED AT LEAST ONE DOSE OF VACCINE

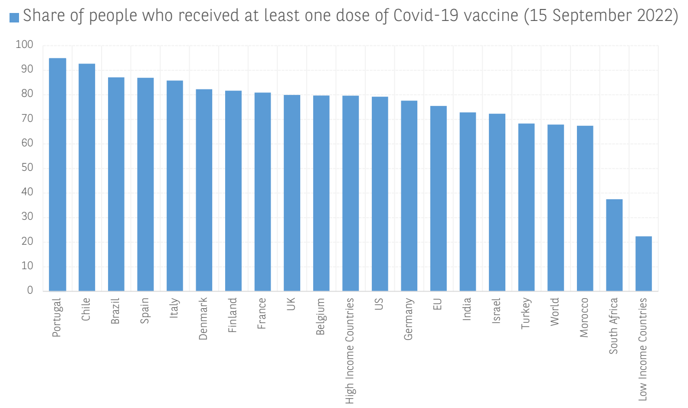
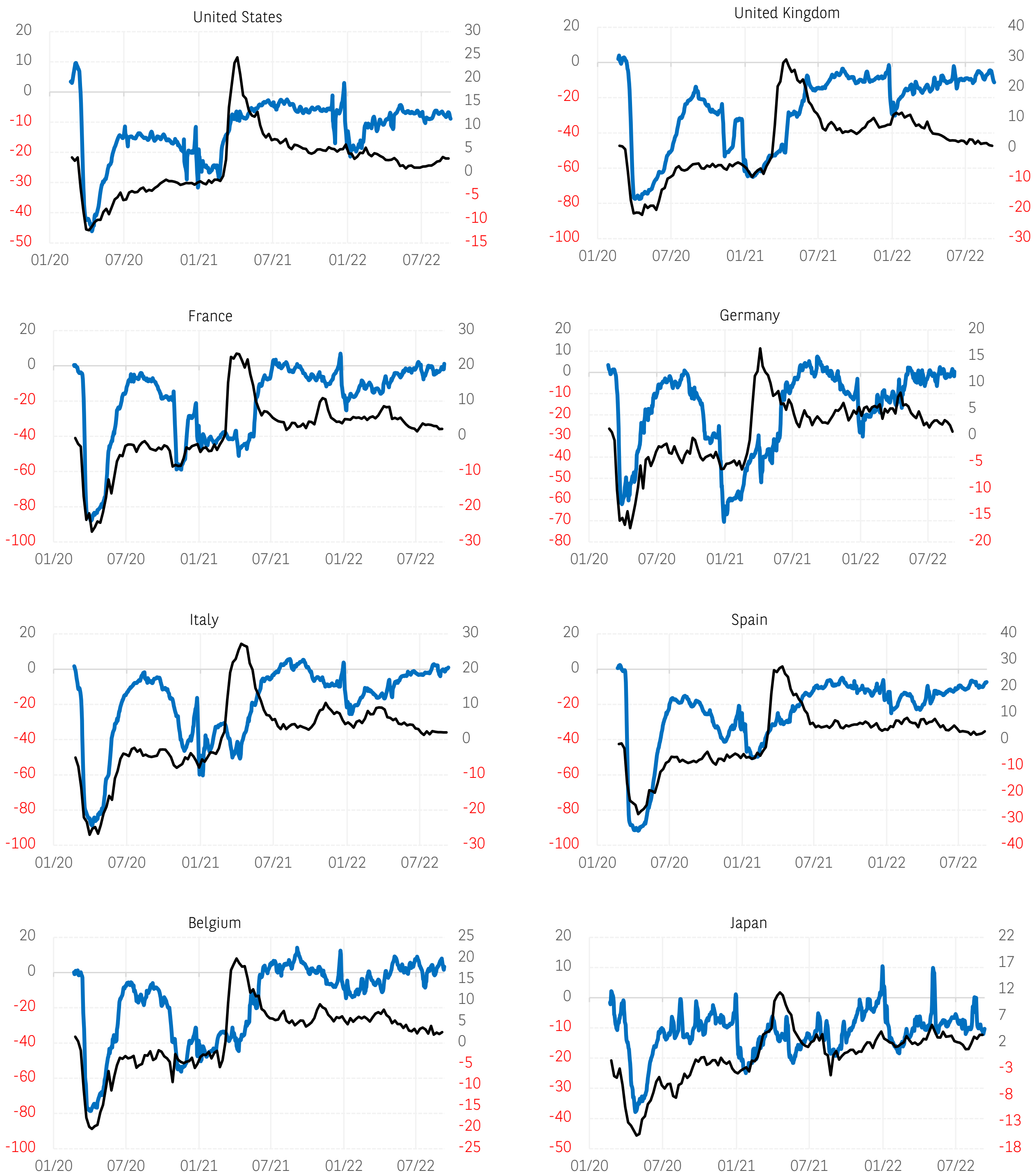


CHART 2 SOURCE: OUR WORLD IN DATA (09/15/2022), BNP PARIBAS

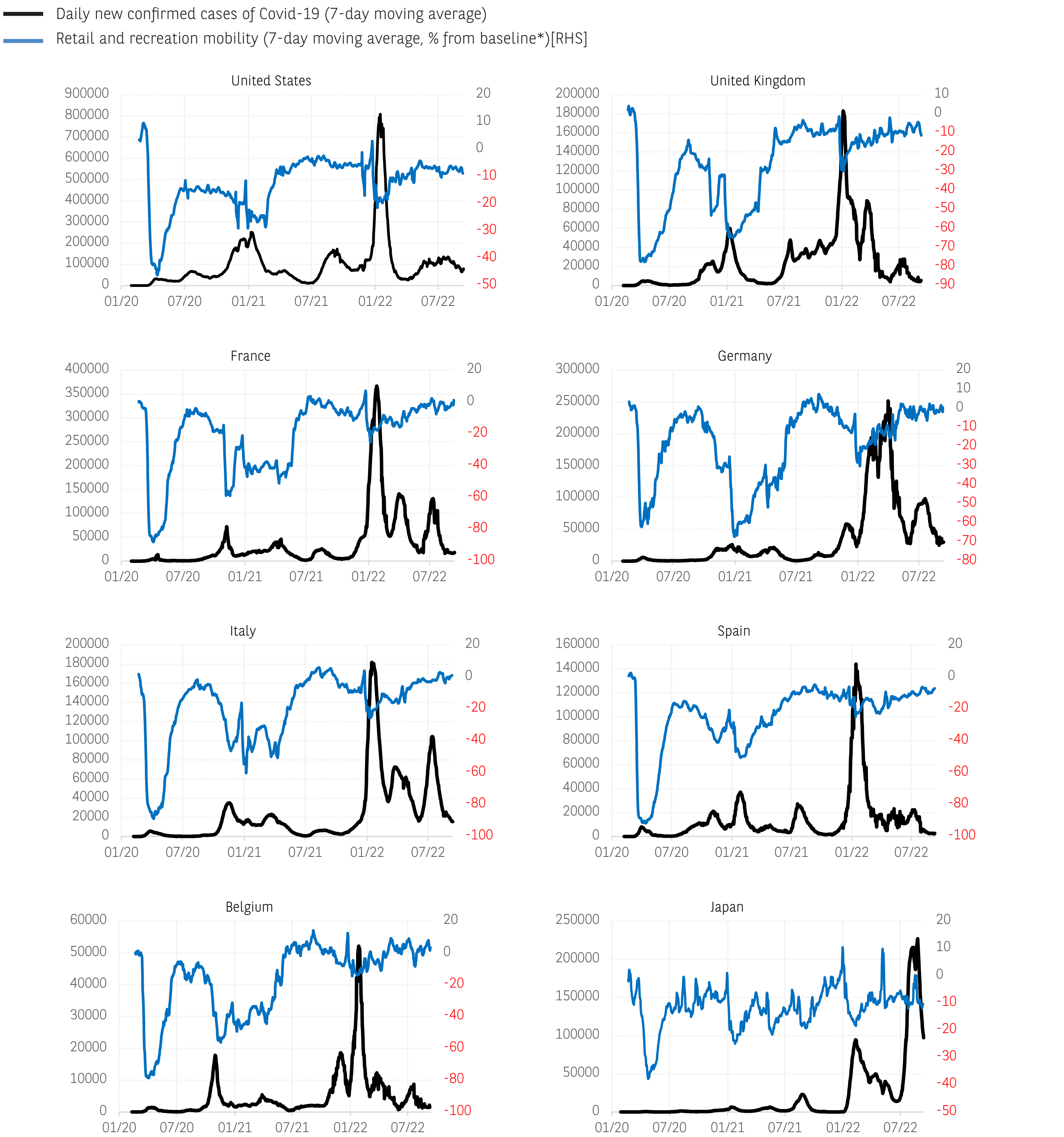
RETAIL AND RECREATION MOBILITY & OECD WEEKLY TRACKER

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



SOURCE: OECD (09/15/2022), GOOGLE (09/15/2022), BNP PARIBAS

DAILY NEW CASES & RETAIL AND RECREATION MOBILITY



SOURCE: JOHNS-HOPKINS UNIVERSITY (09/15/2022), GOOGLE (09/15/2022), BNP PARIBAS

ECONOMIC SCENARIO

UNITED STATES

The US economy is slowing down significantly, with GDP contracting again in Q2 2022, despite strong household consumption and a rebound in exports. Job gains remain robust however and the unemployment rate low, which supports wage growth. However, there are some early signs of a slowdown. Inflation may have peaked in mid-2022 and should continue to decline, but not to move below the 2% target. Facing high and persistent inflation, the Fed continues to raise interest rates "expeditiously" and to shrink its balance sheet. As the mid-term elections approach, the Inflation Reduction Act (IRA) vote represents a victory for President Joe Biden, with the implementation of some of his social and environmental key measures. This plan should also support economic activity. According to our forecasts, the US would not fall into recession, but growth would run below-trend for a prolonged period to ease price pressures.

CHINA

Economic activity contracted in Q2 2022 due to the lockdowns imposed in large industrial regions such as Shanghai. The economic growth rebound since late spring has proved difficult. The authorities are enhancing fiscal and monetary easing measures. However, factors constraining growth remain significant: the correction in the property sector continues, and the deterioration in the labour market, the still tight zero Covid strategy and weak household confidence weigh on private consumption. Moreover, exports are expected to suffer from the slowdown in global demand. Consumer price inflation is accelerating only moderately..

EUROZONE

The look in the rear-view mirror is fairly favorable. The first half of 2022 was better than expected, leading to a comfortable growth carry-over a bit above 3%. However, the outlook for the coming quarters is negative: according to our forecasts, the Eurozone will not escape a contraction of its GDP. The current unprecedented combination of shocks (inflation, health, geopolitical, energy, climate, monetary) should overcome the resilience observed so far. We already have signs of this in the deterioration in confidence surveys, which has intensified over the summer. However, the recession should remain limited in scope thanks to the support of fiscal measures and as long as the labor market continues to perform well as it is now. In annual average terms, we expect Eurozone growth to reach 2.8% in 2022 but only 0.3% in 2023 (2 points lower than in our previous scenario in June). Regarding inflation, we forecast it will soon reach its peak, nearing 10% y/y, before engaging in a rather slow disinflation process in 2023.

FRANCE

Real GDP growth has surprised on the upside in the 2nd quarter of 2022 (+0.5% q/q after -0.2% in the 1st quarter), mainly as a result of tourism (positive contribution of net exports) and accommodation & catering following the unwinding of the bulk of Covid related restrictions. However, inflation has continued to accelerate (reaching a peak of 6.1% y/y in July) and household purchasing power has reduced for a second quarter in a row (-1.1% q/q during the 2nd quarter). Backlog of orders in the manufacturing have continued to decrease, and GDP growth should follow (we expect 0.5% in 2023 after 2.3% in 2022).

RATES AND EXCHANGE RATES

In the US, the Federal Reserve will continue its tightening policy at a swift pace, with a 75bp hike in September, followed by 25bp hikes in both November and December. We expect the terminal rate of 3.75% (upper end of the target range) to hold through 2024. The Fed's hawkish stance is motivated by the 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 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.

After the 50bp rate hike in July and the 75bp increase in September, the ECB Governing Council will continue to raise its policy rates at its next meetings. Policy tightening is frontloaded, which means that the terminal rate -i.e. the peak rate in this cycle- should be reached by the end of the first quarter of next year. We expect a peak for the deposit rate at 2.00%. This should cause an increase in Bund yields.

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 a less dovish policy and a one-off rate hike in the fourth quarter of 2023.

We expect the dollar to weaken somewhat 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 strengthen versus the dollar 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	1.8	1.3	1.4	4.7	7.8	3.0	2.8
Japan	1.7	1.3	0.8	0.6	-0.2	2.2	1.1	0.6
United-Kingdom	7.4	3.4	-0.1	1.4	2.6	9.6	9.3	1.7
Euro Area	5.3	2.8	0.3	1.5	2.6	8.3	6.0	2.4
Germany	2.6	1.4	0.4	1.7	3.2	8.1	4.7	2.4
France	6.8	2.3	0.5	1.5	2.1	5.8	4.2	2.2
Italy	6.6	3.4	0.4	1.6	1.9	8.3	6.1	2.2
Spain	5.1	4.3	0.5	1.7	3.0	8.9	4.5	1.9
China	8.1	3.0	5.3	5.0	0.9	2.3	3.1	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

INTEREST & EXCHANGE RATES

Interest rates, % End of period		Q2 2022	Q4 2022 e	Q1 2023 e	Q2 2023 e	Q4 2023 e
US	Fed Funds (upper limit)	1.75	3.75	3.75	3.75	3.75
	T-Note 10y	2.97	3.20	3.15	3.10	3.00
Eurozone	Deposit rate	-0.50	2.00	2.00	2.00	2.00
	Bund 10y	1.37	1.90	2.20	2.20	2.10
	OAT 10y	1.80	2.55	2.90	2.85	2.75
	BTP 10y	3.29	4.40	4.60	4.50	4.40
	BONO 10y	2.46	3.20	3.70	3.60	3.50
UK	Base rate	1.25	3.00	3.00	3.00	3.00
	Gilts 10y	2.21	2.95	2.95	2.90	2.90
Japan	BoJ Rate	-0.04	-0.10	-0.10	-0.10	0.00
	JGB 10y	0.23	0.25	0.25	0.25	0.45

Exchange Rates End of period		Q2 2022	Q4 2022 e	Q1 2023 e	Q2 2023 e	Q4 2023 e
USD	EUR / USD	1.05	1.00	1.01	1.02	1.06
	USD / JPY	136	137	135	133	127
	GBP / USD	1.21	1.14	1.13	1.13	1.18
EUR	EUR / GBP	0.86	0.88	0.89	0.90	0.90
	EUR / JPY	142	137	136	136	135

Brent End of period		Q2 2022	Q4 2022 e	Q1 2023 e	Q2 2023 e	Q4 2023 e
Brent	USD/bbl	115	100	102	107	115

SOURCES: BNP PARIBAS (E: ESTIMATES & FORECASTS) (MARKET ECONOMICS, INTEREST RATE STRATEGY, FX STRATEG, COMMODITIES DESK STRATEGY) , * LAST UPDATE 09/05/2022

CALENDAR

LATEST INDICATORS

In Germany, the ZEW survey disappointed with the assessment of the current situation as well as the expectations component both dropping more than expected. In the UK, inflation declined slightly more than anticipated by the consensus, whilst remaining very elevated. Retail sales in August registered a big drop. Job creation has slowed down significantly and far more than expected. In the US, mortgage applications were down again, reflecting the hit coming from higher mortgage rates. Retail sales on the other hand did well and the surprising decline in initial unemployment claims shows that the labour market is still in good shape. University of Michigan sentiment edged higher. Short and long-term inflation expectations declined slightly. Core producer price inflation on the other hand disappointed by increasing more than expected in August. Consumer price inflation also disappointed, causing an increase in rate hike expectations and a big drop in the equity market. In the euro area, the final August numbers for inflation were in line with the flash estimate and remind us of the challenge faced by the ECB. Most of the data in China for the month of August showed some improvement compared to the previous month. Retail sales, industrial production and fixed assets investments did well and better than expected. The data for the property sector continue to show big declines versus last year.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	ACTUAL	PREVIOUS
09/13/2022	United Kingdom	Employment Change 3M/3M	Jul	125k	40k	160k
09/13/2022	Germany	ZEW Survey Expectations	Sep	-59.5	-61.9	-55.3
09/13/2022	Germany	ZEW Survey Current Situation	Sep	-52.1	-60.5	-47.6
09/13/2022	Eurozone	ZEW Survey Expectations	Sep	--	-60.7	-54.9
09/13/2022	United States	CPI MoM	Aug	-0.10%	0.10%	0.00%
09/13/2022	United States	CPI Ex Food and Energy MoM	Aug	0.30%	0.60%	0.30%
09/14/2022	United Kingdom	CPIH YoY	Aug	8.70%	8.60%	8.80%
09/14/2022	United States	MBA Mortgage Applications	Sep	--	-1.20%	-0.80%
09/14/2022	United States	PPI Ex Food and Energy MoM	Aug	0.30%	0.40%	0.30%
09/15/2022	United States	Initial Jobless Claims	Sep	227k	213k	218k
09/15/2022	United States	Retail Sales Advance MoM	Aug	-0.10%	0.30%	-0.40%
09/16/2022	China	Residential Property Sales YTD YoY	Aug	--	-30.30%	-31.40%
09/16/2022	China	Industrial Production YoY	Aug	3.80%	4.20%	3.80%
09/16/2022	China	Retail Sales YoY	Aug	3.30%	5.40%	2.70%
09/16/2022	China	Fixed Assets Ex Rural YTD YoY	Aug	5.50%	5.80%	5.70%
09/16/2022	China	Property Investment YTD YoY	Aug	-7.00%	-7.40%	-6.40%
09/16/2022	China	Surveyed Jobless Rate	Aug	5.40%	5.30%	5.40%
09/16/2022	United Kingdom	Retail Sales Ex Auto Fuel MoM	Aug	-0.70%	-1.60%	0.40%
09/16/2022	Eurozone	CPI YoY	Aug	9.10%	9.10%	9.10%
09/16/2022	Eurozone	CPI MoM	Aug	0.50%	0.60%	0.50%
09/16/2022	Eurozone	CPI Core YoY	Aug	4.30%	4.30%	4.30%
09/16/2022	United States	U. of Mich. Sentiment	Sep	60.0	59.5	58.2
09/16/2022	United States	U. of Mich. 1 Yr Inflation	Sep	4.60%	4.60%	4.80%
09/16/2022	United States	U. of Mich. 5-10 Yr Inflation	Sep	2.9%	2.8%	2.9%

SOURCE: BLOOMBERG

CALENDAR: THE WEEK AHEAD

COMING INDICATORS

It's an important week with meetings of the Federal Reserve, the Bank of England and the Bank of Japan, with the bulk of the attention going to the FOMC decision given the disappointing inflation data in August. In the US, several data will be released about the real estate market. We will also have the Conference Board index of leading economic indicators. This index has been on a downward trend for several months now. In the past, such a development has been followed by a recession. Several surveys will be published covering the month of September: consumer confidence in the euro area and in the UK, business confidence in France and, importantly, the flash PMIs in several countries.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	PREVIOUS
09/19/2022	United States	NAHB Housing Market Index	Sep	48	49
09/20/2022	United States	Building Permits MoM	Aug	-3.80%	-1.30%
09/20/2022	United States	Housing Starts MoM	Aug	1.00%	-9.60%
09/21/2022	United Kingdom	CBI Trends Total Orders	Sep	-11	-7
09/21/2022	United Kingdom	CBI Trends Selling Prices	Sep	--	57
09/21/2022	United States	MBA Mortgage Applications	Sep	--	-1.20%
09/21/2022	United States	Existing Home Sales MoM	Aug	-2.30%	-5.90%
09/21/2022	United States	FOMC Rate Decision (Upper Bound)	Sep	3.25%	2.50%
09/22/2022	France	Business Confidence	Sep	102	103
09/22/2022	Eurozone	ECB Publishes Economic Bulletin	Sep		
09/22/2022	United Kingdom	Bank of England Bank Rate	Sep	2.25%	1.75%
09/22/2022	United States	Initial Jobless Claims	Sep	--	213k
09/22/2022	United States	Leading Index	Aug	0.00%	-0.40%
09/22/2022	Eurozone	Consumer Confidence	Sep P	-25	-24.9
09/22/2022	Japan	BOJ Policy Balance Rate	Sep	--	-0.10%
09/23/2022	United Kingdom	GfK Consumer Confidence	Sep	-42	-44
09/23/2022	France	S&P Global France Manufacturing PMI	Sep	49.8	50.6
09/23/2022	France	S&P Global France Services PMI	Sep	50.3	51.2
09/23/2022	Germany	S&P Global/BME Germany Manufacturing PMI	Sep	48.2	49.1
09/23/2022	Germany	S&P Global Germany Services PMI	Sep	47.2	47.7
09/23/2022	Eurozone	S&P Global Eurozone Manufacturing PMI	Sep	49	49.6
09/23/2022	Eurozone	S&P Global Eurozone Services PMI	Sep	49	49.8
09/23/2022	United Kingdom	S&P Global/CIPS UK Manufacturing PMI	Sep	47.4	47.3
09/23/2022	United Kingdom	S&P Global/CIPS UK Services PMI	Sep	49	50.9
09/23/2022	United States	S&P Global US Manufacturing PMI	Sep	51.3	51.5
09/23/2022	United States	S&P Global US Services PMI	Sep	45	43.7

SOURCE: BLOOMBERG

FURTHER READING

Latin America : the mechanisms of inflation	EcoTVWeek	19 September 2022
Global : 2022, towards a likely new record in CO2 emissions	Chart of the Week	15 September 2022
Global : What drives the pace of disinflation?	EcoWeek	12 September 2022
Eurozone: a positive first half of the year to be followed by a negative second half?	EcoTVWeek	9 September 2022
Sweden: Can populist forces take power in Sweden?	EcoFlash	9 September 2022
Chile: rejection of the draft constitution	Chart of the Week	7 September 2022
Global: Towards a frugal winter	EcoWeek	5 September 2022
Monetary policy : from theory without end to the end of theory	EcoTVWeek	2 September 2022
Eurozone: the rise in corporate bond yields makes bank lending more attractive for non-financial corporations	Chart of the Week	31 July 2022
Global: The new meaning of 'whatever it takes'	EcoWeek	29 July 2022
Heightened risk despite agreement with IMF	Chart of the Week	27 July 2022
France : Reconciling short-term and medium-term challenges	Conjoncture	26 July 2022
Eurozone : ECB: Into a new era	EcoWeek	25 July 2022
Turkey: on the razor's edge	EcoTVWeek	22 July 2022
Germany : A mixed bag for pay rises in 2022	EcoFlash	21 July 2022
Spain: the effects of the labour-market reforms in Spain are clearly visible	Chart of the Week	20 July 2022
Algeria : A window of opportunity not to be missed	Conjoncture	20 July 2022
Eurozone : ECB: addressing unwarranted spread widening	EcoWeek	18 July 2022
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

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