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BNP PARIBAS

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for a changing
world

US: BYE BYE QE, HERE COMES QT

The minutes of the December meeting of the Federal Open Market Committee (FOMC) have shown a distinct and sudden shift towards a more hawkish stance. The reduction of the pace of net asset purchases (tapering) has been stepped up, the first rate hike is expected to come earlier and the FOMC participants favour an early start and a faster pace of quantitative tightening (QT). Although they are more relaxed about QT than in 2017, it remains a tricky operation. The challenge will be to find the right balance between QT and the number of rate hikes in order to bring inflation under control without jeopardizing growth. History shows that achieving a soft landing is difficult.

Since the global financial crisis of 2008, the management of the size of the central bank's balance sheet has become an integral part of the monetary policy toolkit, alongside the policy rate and forward guidance. This applies when the emphasis is on policy easing but also when the focus is on reducing monetary accommodation, like is the case now in the US. Indeed, the minutes of the December meeting of the Federal Open Market Committee (FOMC) have shown a distinct and sudden shift towards a more hawkish stance. This has put upward pressure on government bond yields in the US and abroad (chart 1). This shift comes on top of the upward revision of the FOMC members' interest rate projections – the 'dots' – and the announcement of a faster reduction in the net asset purchases (tapering). It is reflected in the comment that "*it may become warranted to increase the federal funds rate sooner or at a faster pace than participants had earlier anticipated*" and in the 'discussion of policy normalization considerations'. Regarding the latter, the key takeaways from the minutes are that "*almost all participants agreed that it would likely be appropriate to initiate balance sheet runoff at some point after the first increase in the target range for the federal funds rate*". Moreover, "*many participants judged that the appropriate pace of balance sheet runoff would likely be faster than it was during the previous normalization episode.*" This is a big difference with 2017 when the rate hike cycle was already well underway before the balance sheet runoff (quantitative tightening, QT) started (chart 2). Moreover, on that occasion, the unease about the potential impact of QT on financial markets was such that Fed Chair Janet Yellen compared the reduction of the Fed's balance sheet to watching paint dry, i.e. something very uneventful[1].

At the current juncture, the FOMC participants favour an early start and a faster pace of QT because, compared with 2016-17, the economic outlook is much stronger, inflation is higher, the labour market looks tighter and the balance sheet is much larger. Nevertheless, QT remains a tricky operation. One, the impact on flows in the market is potentially significant. When Treasury securities reach their maturity date, new securities will be issued but, when the Federal Reserve is running off its balance sheet, it will not reinvest or at least not for the full amount[2]. Other investors, both in the US and abroad, will have to increase their holdings of Treasuries and may need to be enticed to do so, which will put upward pressure on bond yields[3]. However, this also depends on net issuance, which is driven by the budget deficit. This latter is expected to decline whereby the effect in terms of flows would dominate that coming from QT[4]. Two, QT and policy rate hikes are substitutes. Both are supposed to slow down growth. The bigger the reduction in the balance sheet, the less room there is to increase the federal funds rate. As a consequence, in the next easing cycle, the potential for cutting rates may be rapidly exhausted. This may push the Fed to favour rate hikes and to limit the runoff of its balance sheet. Three, FOMC participants

1. "*It will be like watching paint dry, that this will just be something that runs quietly in the background.*" Source: Federal Reserve, Transcript of Chair Yellen's Press Conference, 14 June 2017.
2. The same reasoning of course applies for the mortgage-backed securities bought by the Federal Reserve.
3. Chart 2 shows the complex relationship between the federal funds rate and the size of the balance sheet on the one hand and Treasury yields on the other hand. The rate hike cycle that started at the end of 2016 caused an increase in bond yields and QT -which started in October 2017 and ended in August 2019- initially probably contributed to this development. In the fall of 2018 however, investors started to anticipate that the peak in the federal funds rate was about to be reached. This triggered a decline in Treasury yields although the balance sheet runoff continued.
4. BNPP Global Markets Rates Strategy expects the reduction of the Fed's balance sheet to reach USD 100 bn per month by December 2022 yet the net supply of US Treasuries is projected to decline from USD 1050 bn in 2021, to USD 934 bn in 2022 and USD 592 bn in 2023.

10-YEAR TREASURY AND BUND YIELD SINCE THE START OF 2021

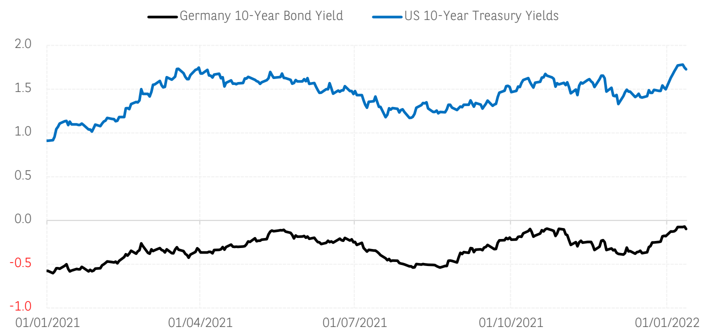


CHART 1 SOURCE: BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REFINITIV, BNP PARIBAS

> Several FOMC members have expressed concerns about vulnerabilities in the Treasury market in reaction to quantitative tightening, but eventually the real vulnerability will be in riskier asset classes like equities, corporate bonds or real estate due to mounting fears about the growth outlook.

consider that "as *in the previous normalization episode ... changes in the target range for the federal funds rate should be the Committee's primary means for adjusting the stance of monetary policy*" because there is less uncertainty about the effects of an increase in official interest rates. Moreover, it is easier to communicate to the general public about interest rate hikes than about QT.

Considering that the FOMC seems to be quite relaxed about using QT, the debate will center around speed and size of the runoff. The challenge will be to find the right balance between QT and rate hikes in order to bring inflation under control without jeopardizing growth. History shows that achieving a soft landing is difficult. Several FOMC members have expressed concerns about vulnerabilities in the Treasury market in reaction to quantitative tightening, but eventually the real vulnerability will be in riskier asset classes like equities, corporate bonds or real estate due to mounting fears about the growth outlook.

William De Vijlder

FEDERAL RESERVE BALANCE SHEET, FEDERAL FUNDS RATE AND TREASURY YIELD

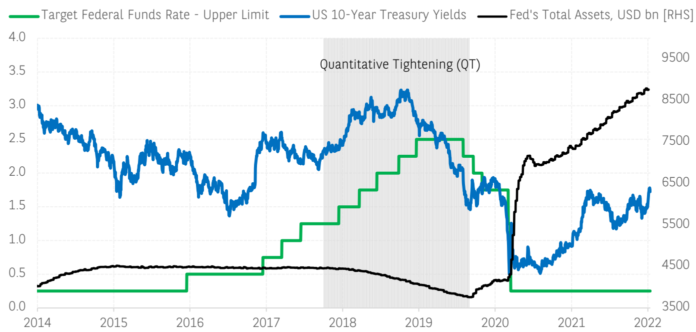


CHART 2

SOURCE: REFINITIV, BNP PARIBAS

MARKETS OVERVIEW

OVERVIEW

Week 7-1 22 to 14-1-22

↘ CAC 40	7 219	▸	7 143	-1.1	%
↘ S&P 500	4 677	▸	4 663	-0.3	%
↗ Volatility (VIX)	18.8	▸	19.2	+0.4	pb
↗ Euribor 3M (%)	-0.58	▸	-0.57	+0.8	bp
↗ Libor $ 3M (%)	0.24	▸	0.24	+0.5	bp
↘ OAT 10y (%)	0.21	▸	0.21	-0.2	bp
↘ Bund 10y (%)	-0.08	▸	-0.09	-1.1	bp
↗ US Tr. 10y (%)	1.77	▸	1.77	+0.2	bp
↗ Euro vs dollar	1.13	▸	1.14	+0.8	%
↗ Gold (ounce, $)	1 792	▸	1 821	+1.7	%
↗ Oil (Brent, $)	81.9	▸	86.2	+5.2	%

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	-0.57	-0.56	at	12/01	-0.58	at	05/01
Euribor 12M	-0.48	-0.48	at	12/01	-0.50	at	05/01
$ FED	0.25	0.25	at	03/01	0.25	at	03/01
Libor 3M	0.24	0.24	at	11/01	0.21	at	03/01
Libor 12M	0.73	0.73	at	14/01	0.58	at	03/01
£ BoE	0.25	0.25	at	03/01	0.25	at	03/01
Libor 3M	0.52	0.52	at	14/01	0.26	at	03/01
Libor 12M	0.81	0.81	at	03/01	0.81	at	03/01

At 14-1-22

Yield (%)		highest 22		lowest 22	
€ AVG 5-7y	0.01	0.04	at 12/01	-0.04	at 03/01
Bund 2y	-0.62	-0.60	at 07/01	-0.64	at 05/01
Bund 10y	-0.09	-0.07	at 11/01	-0.13	at 04/01
OAT 10y	0.21	0.23	at 11/01	0.15	at 04/01
Corp. BBB	1.00	1.00	at 14/01	0.90	at 05/01
$ Treas. 2y	0.97	0.97	at 14/01	0.70	at 04/01
Treas. 10y	1.77	1.78	at 10/01	1.63	at 03/01
High Yield	5.24	5.24	at 10/01	5.07	at 03/01
£ gilt. 2y	0.80	0.84	at 10/01	0.69	at 03/01
gilt. 10y	1.15	1.19	at 10/01	0.97	at 03/01

At 14-1-22

EXCHANGE RATES

1€ =		highest 22			lowest 22			2022
USD	1.14	1.15	at	13/01	1.13	at	03/01	+0.5%
GBP	0.84	0.84	at	03/01	0.83	at	11/01	-0.5%
CHF	1.04	1.05	at	11/01	1.03	at	04/01	+0.6%
JPY	130.10	131.33	at	04/01	130.10	at	14/01	-0.7%
AUD	1.58	1.58	at	07/01	1.56	at	05/01	+1.1%
CNY	7.25	7.29	at	13/01	7.20	at	03/01	+0.1%
BRL	6.33	6.44	at	06/01	6.32	at	13/01	-0.1%
RUB	87.14	87.44	at	13/01	84.45	at	03/01	+2.2%
INR	84.79	84.79	at	14/01	83.81	at	10/01	+0.3%

At 14-1-22 *Change*

COMMODITIES

Spot price, $		highest 22			lowest 22			2022	2022(€)
Oil, Brent	86.2	86.2	at	14/01	79.0	at	03/01	+9.9%	+9.3%
Gold (ounce)	1 821	1 825	at	05/01	1 792	at	07/01	-0.1%	-0.6%
Metals, LMEX	4 589	4 687	at	12/01	4 489	at	06/01	+1.9%	+1.4%
Copper (ton)	9 730	10 081	at	12/01	9 543	at	06/01	-0.1%	-0.6%
wheat (ton)	281	2.9	at	04/01	281	at	14/01	+18.1%	+17.4%
Corn (ton)	230	2.3	at	04/01	226	at	03/01	+0.1%	-0.0%

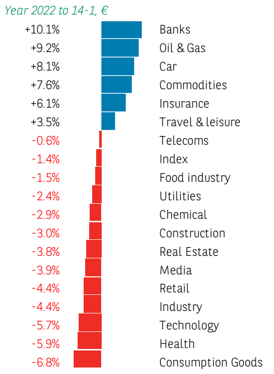
At 14-1-22 *Change*

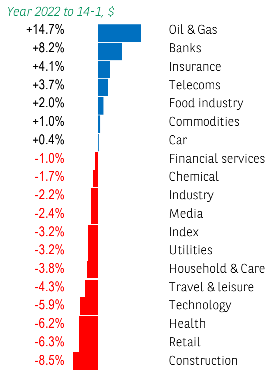
EQUITY INDICES

	Index	highest 22			lowest 22			2022
World								
MSCI World	3 173	3 248	at	04/01	3 166	at	10/01	-1.8%
North America								
S&P500	4 663	4 797	at	03/01	4 659	at	13/01	-2.2%
Europe								
EuroStoxx50	4 272	4 392	at	05/01	4 240	at	10/01	-0.6%
CAC 40	7 143	7 376	at	05/01	7 116	at	10/01	-0.0%
DAX 30	15 883	16 272	at	05/01	15 768	at	10/01	-0.0%
IBEX 35	8 807	8 817	at	13/01	8 707	at	10/01	+0.1%
FTSE100	7 543	7 564	at	13/01	7 385	at	03/01	+0.2%
Asia								
MSCI, loc.	1 138	1 165	at	05/01	1 138	at	14/01	-0.0%
Nikkei	28 124	29 332	at	05/01	28 124	at	14/01	-2.3%
Emerging								
MSCI Emerging ($)	1 257	1 267	at	12/01	1 217	at	06/01	+0.2%
China	85	86	at	12/01	80	at	05/01	+1.0%
India	887	891	at	13/01	856	at	03/01	+4.8%
Brazil	1 490	1 490	at	14/01	1 372	at	06/01	+3.2%
Russia	708	772	at	03/01	708	at	14/01	-5.2%

At 14-1-22 *Change*

PERFORMANCE BY SECTOR (Eurostoxx50 & S&P500)

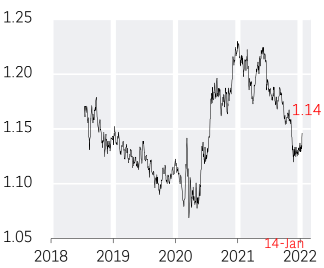




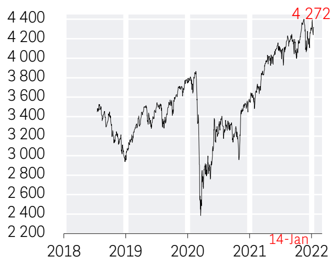
SOURCE: REFINITIV, BNP PARIBAS,

MARKETS OVERVIEW

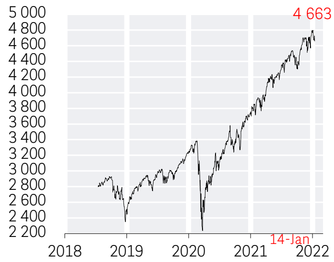
EURO-DOLLAR



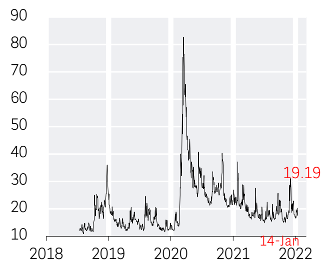
EUROSTOXX50



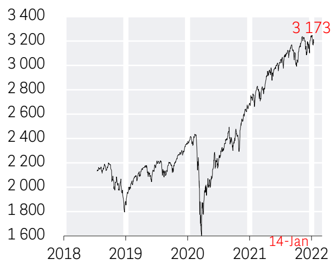
S&P500



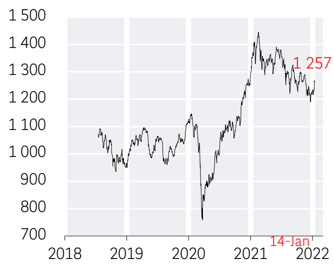
VOLATILITY (VIX, S&P500)



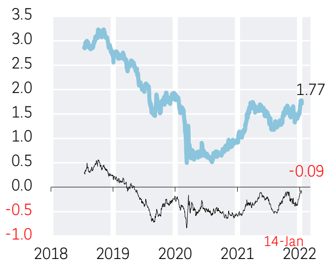
MSCI WORLD (USD)



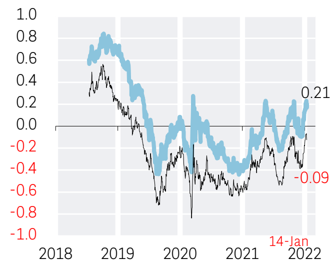
MSCI EMERGING (USD)



10Y BOND YIELD, TREASURIES VS BUND

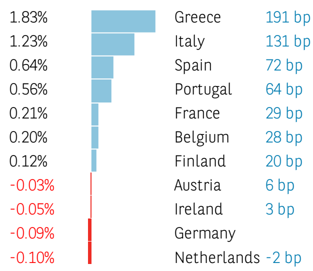


10Y BOND YIELD

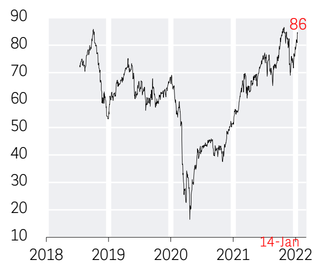


10Y BOND YIELD & SPREADS

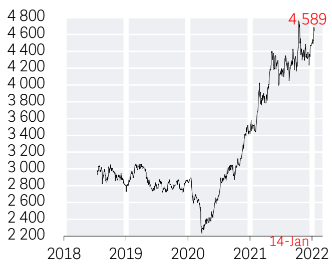
Year 2022 to 14-1



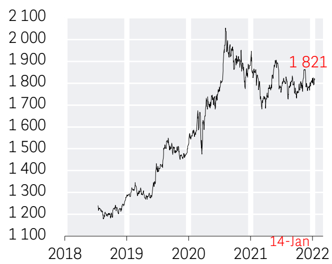
OIL (BRENT, USD)



METALS (LMEX, USD)



GOLD (OUNCE, USD)



SOURCE: REFINITIV, BNP PARIBAS

ECONOMIC PULSE

ITALY: WAITING FOR THE PRESIDENTIAL ELECTION

With less than two weeks to go before Italy's presidential election – the first round of voting takes place on 24 January – a candidacy of the current Prime Minister, Mario Draghi, remains a distinct possibility. If Mr Draghi becomes Italy's president, this would probably have repercussions for the current governing coalition, although it is not currently possible to predict what they might be.

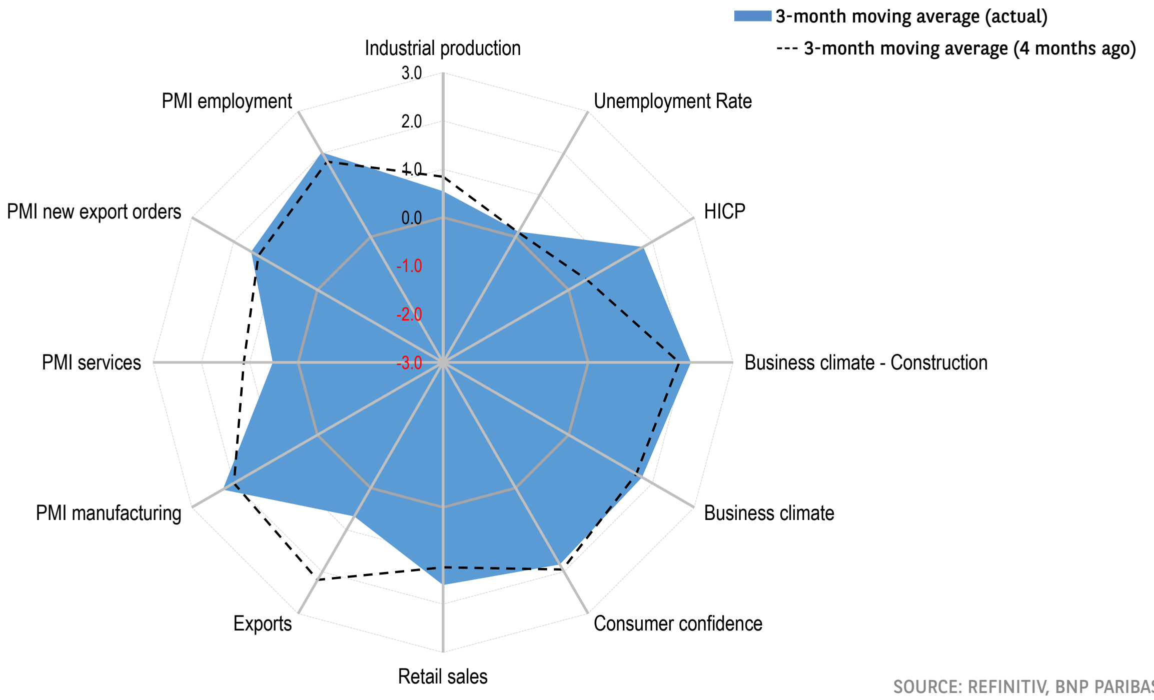
In the meantime, Covid-19 cases are continuing to surge, with around 170 000 new contaminations recorded in mid-January. This has prompted the government to make vaccinations compulsory for people aged over 50. However, the current Covid-19 situation is not having a significant impact on business and consumer confidence, or at least the impact is much less than during the winter 2020 wave. The composite PMI shows that economic activity remained strong in December (54.7). The indicator for the manufacturing sector even continued to improve, while consumer confidence (measured by the European Commission) is not showing any real weakness, although it fell slightly in the fourth quarter of 2021.

However, there is a noticeable difference between, on the one hand, the positive signals coming from manufacturing opinion surveys and, on the other hand, the current level of production, which is more muted although it rose sharply in November (+4.6% m/m). This largely reflects that constraints are more on the supply side, with shortages of inputs and extended delivery times, than on the demand side. Evidence for this is provided by the continuing rise in the PMI component for backlogs of work, which hit a record 63.1 in December.

Italy's jobs market is continuing to recover, but at a slower pace than in neighbouring countries. Italy still has 145,000 fewer jobs than it did at the end of 2019 and is also suffering from a significant shrinkage in its labour force, which is currently around a third smaller than it was before the pandemic. Overall, the unemployment rate has been stable since summer 2021, although at 9.2% in November, it remained the third highest in the European Union after Spain and Greece.

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 +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.

SPAIN: CONFIDENCE WANING, EMPLOYMENT RESILIENT

The fairly substantial upgrade to Spain's Q3 GDP figures underlined again the problems that the Spanish statistical office (INE) is currently facing when collecting data. To recap, third-quarter growth was revised up from 2.0% q/q to 2.6% q/q and this follows a large downgrade for Q2, from 2.8% q/q to 1.1% q/q.

Employment will remain in the spotlight in 2022, since it offers a parallel measurement of economic activity and one that is currently more accurate than GDP. Last year was very solid in terms of job creation. Almost 473,000 positions were filled[1], pushing total employment towards all-time highs. The pace of new hires slowed marginally in Q4, despite the deterioration on the Covid-19 front. Jobs figures for January 2022, published on February 2nd, will be very important in this respect and will give a better picture of how resilient the economy is to the latest wave of the pandemic. However, the unemployment rate remains high, coming in at 14.1% in November.

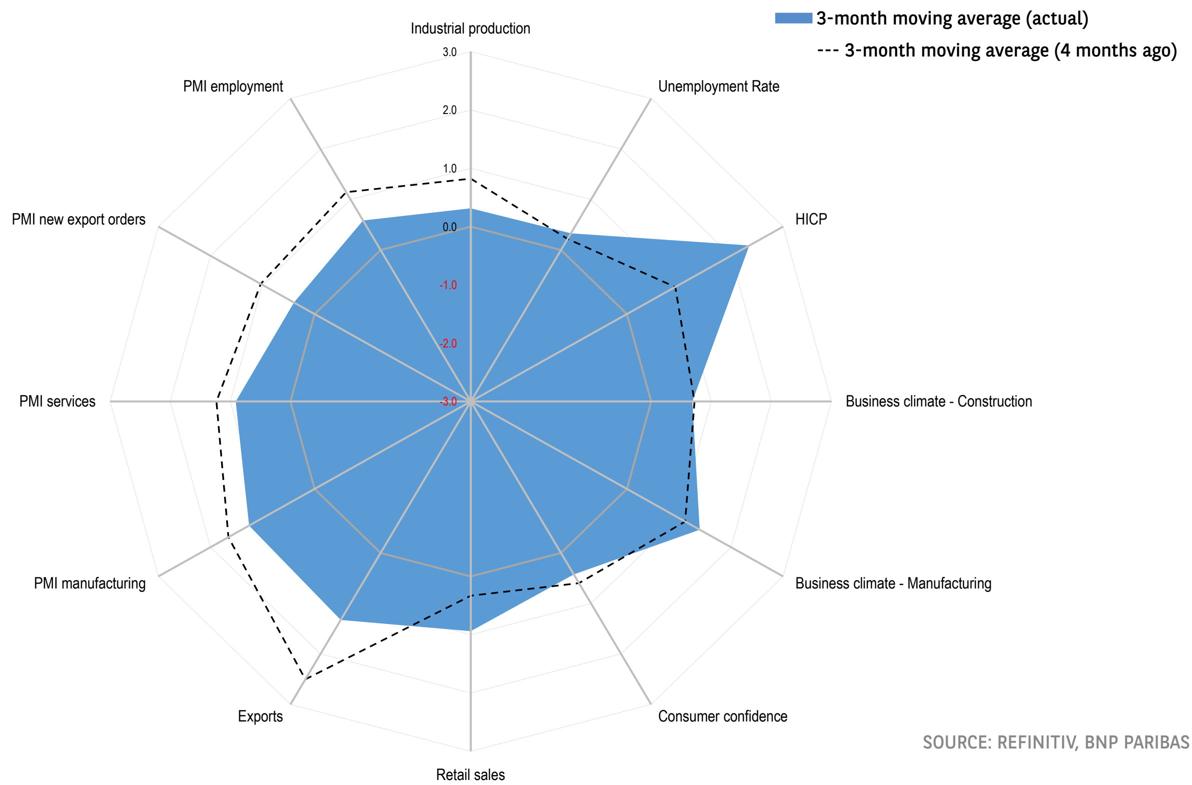
Falling confidence figures, as shown by our barometer, suggest that growth will slow this winter. PMI figures also declined in the fourth quarter of 2021, as did the European Commission's Economic Sentiment Index (ESI). Consumer confidence has fallen to its lowest level since March 2021, mainly because consumers are less able to save and are more pessimistic about economic developments in the next 12 months.

The deterioration is the result of both pandemic developments and rising inflation, which is becoming more entrenched with each passing month. Current increases in gas prices and larger rises in input prices – mainly in the energy and food sectors – will keep inflation high in 2022. As a result, bond yields are likely to rise gradually. Spanish 10-year sovereign bond yields reached 0.65% on 7 January, their highest level since May 2020. However, the spread to German Bunds has remained stable.

Guillaume Derrien

1. According to figures from the Spanish employment service (SEPE).

SPAIN: QUARTERLY CHANGES



SOURCE: REFINITIV, BNP PARIBAS

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UNITED KINGDOM: LIKE A BOOMERANG...

Military parades, outdoor concerts and a pudding competition: whilst the UK prepares its lavish celebrations of Queen Elizabeth II's platinum jubilee, marking her 70 years on the throne, her Prime Minister, Boris Johnson, faces a less glorious present. Weakened by the so-called 'Partygate' affair (relating to "recreational get-togethers" held at 10 Downing Street during lockdown), the PM has seen his popularity collapse in lockstep with that of Brexit, whose supposed benefits have yet to materialise. One year after the UK's effective withdrawal from the EU Single Market, the balance of opinions about the country's new solo adventure has never been so negative (50% of the population believe that it was a bad decision; only 38% think the opposite, with 12% not offering an opinion[1]).

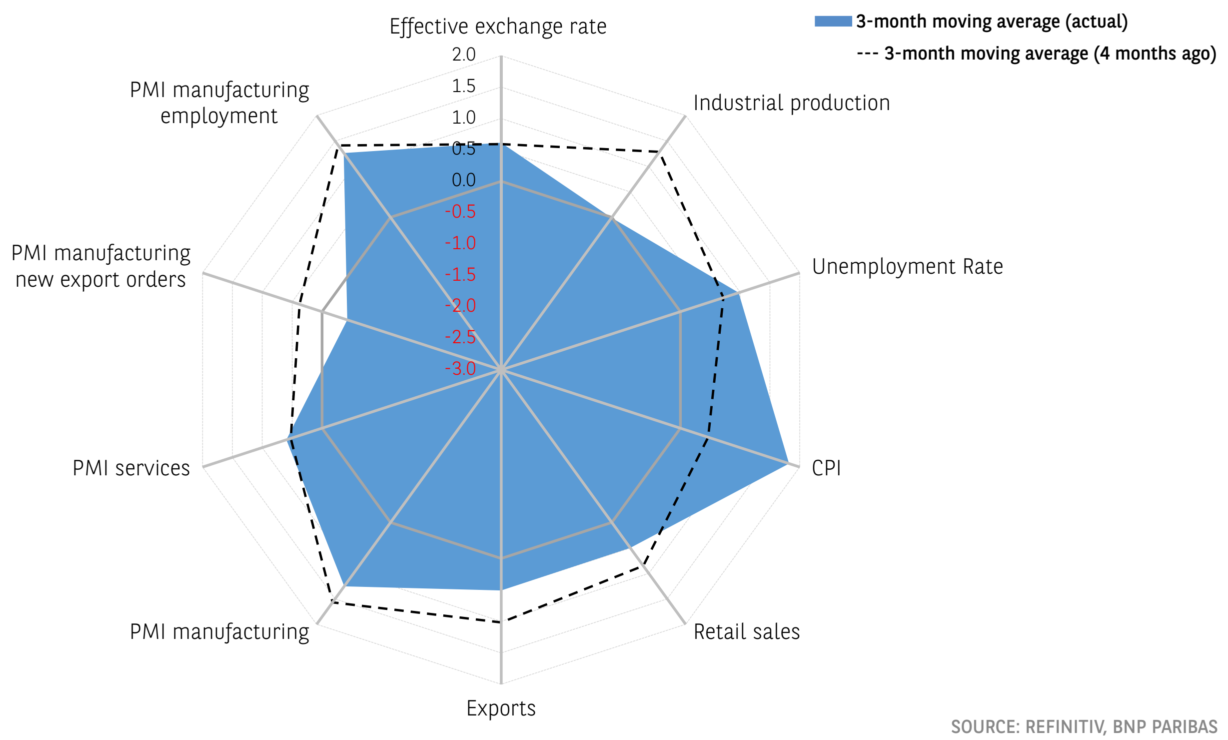
Although the shock of the Covid-19 pandemic makes analysis harder, the costs of Brexit are clear in a number of trends, starting with figures for international trade. Compared to pre-pandemic levels, trade volumes have fallen by far more than in any other advanced economy. Whilst Eurozone trade has pretty much returned to Q4 2019 levels, the UK's exports of goods and services at constant prices are still down 21%[2]. Unsurprisingly, it has been trade with the European Union, where border formalities have been reintroduced (VAT declarations, sanitary checks and so forth), that has taken the biggest hit.

Nor indeed is inward direct investment what it once was. In anticipation of Brexit, many foreign banks, particularly those from the US, reallocated their portfolios towards the Eurozone[3]. Without completely inverting, net direct investment flows, which the UK traditionally attracted, were cut by eight since the Leave vote in 2016[4]. There is no sign of Mr Johnson's much vaunted 'Global Britain' in the numbers.

Jean-Luc Proutat

1. Source: NatCen Social Research, 7 January 2022.
2. Based on national accounting data available to the third quarter of 2021.
3. Choulet C. (2021), *USA: reallocation of bank portfolios towards the euro zone since Brexit, BNP Paribas*, Chart of the week, November.
4. Over the five years from 2017 to 2021 (third quarter), net inward direct investment in the UK was GBP 51 billion, compared to GBP 425 billion in the five years from 2012 to 2016. Source: Office for National Statistics.

UK: 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 +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.

NEW COVID-19 CASE NUMBERS CONTINUE TO RISE SHARPLY

The weekly number of new Covid-19 cases remains very high in most regions because of the Omicron variant. 16.8 million new cases were reported in the week of 6-12 January. Although the growth rate has declined from 79% to 59% it still is very elevated. The largest weekly increases were recorded in South America (149%) and Asia (145%), followed by North America (58%), Europe (37%) and Africa (2.2%) (chart 1).

On a weekly basis, the highest number of new cases in a single country (chart 4, black line) was in the USA (5,591,891). France was next with 2,057,066 cases, followed by India (1,355,743), Italy (1,165,515), the UK (956,745, -24% versus the previous week), Spain (881,522), Argentina and Australia (almost 720,000). To date, 9.57 billion Covid-19 vaccine doses have been administered worldwide since vaccination campaigns began in the fourth quarter of 2020, including 813 million booster doses. Nearly 60% 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, where 77% of the population has received at least one dose, and low-income countries (8%) (chart 2).

On the mobility front, visits to retail and leisure facilities remain on a downward trend in Germany, Belgium, Italy, France, Spain, the US and the UK, although the most recent numbers show an uptick. In Japan, mobility is falling fairly sharply after previously showing positive momentum (chart 3, blue line).

Lastly, the trend in the weekly proxy indicator of GDP has remained negative in Germany, Belgium, Spain and Italy, and to a lesser extent in France and the USA. It remains positive in Japan and has stabilised 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)

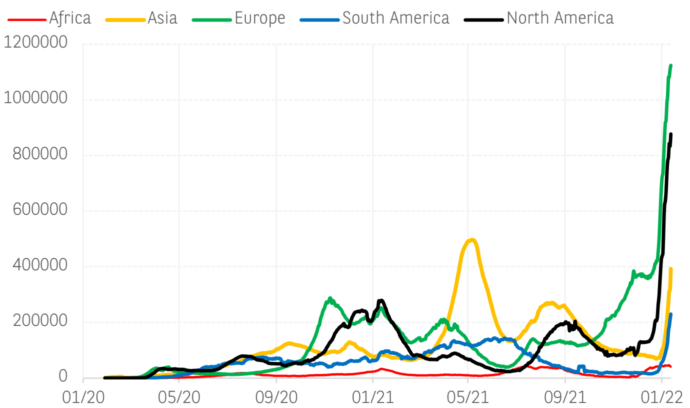


CHART 1 SOURCE: JOHNS-HOPKINS UNIVERSITY (01/13/2022), BNP PARIBAS

SHARE OF PEOPLE WHO RECEIVED AT LEAST ONE DOSE OF VACCINE

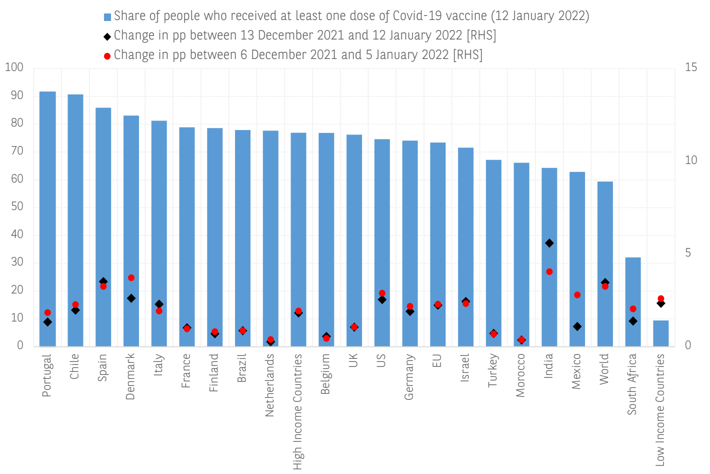
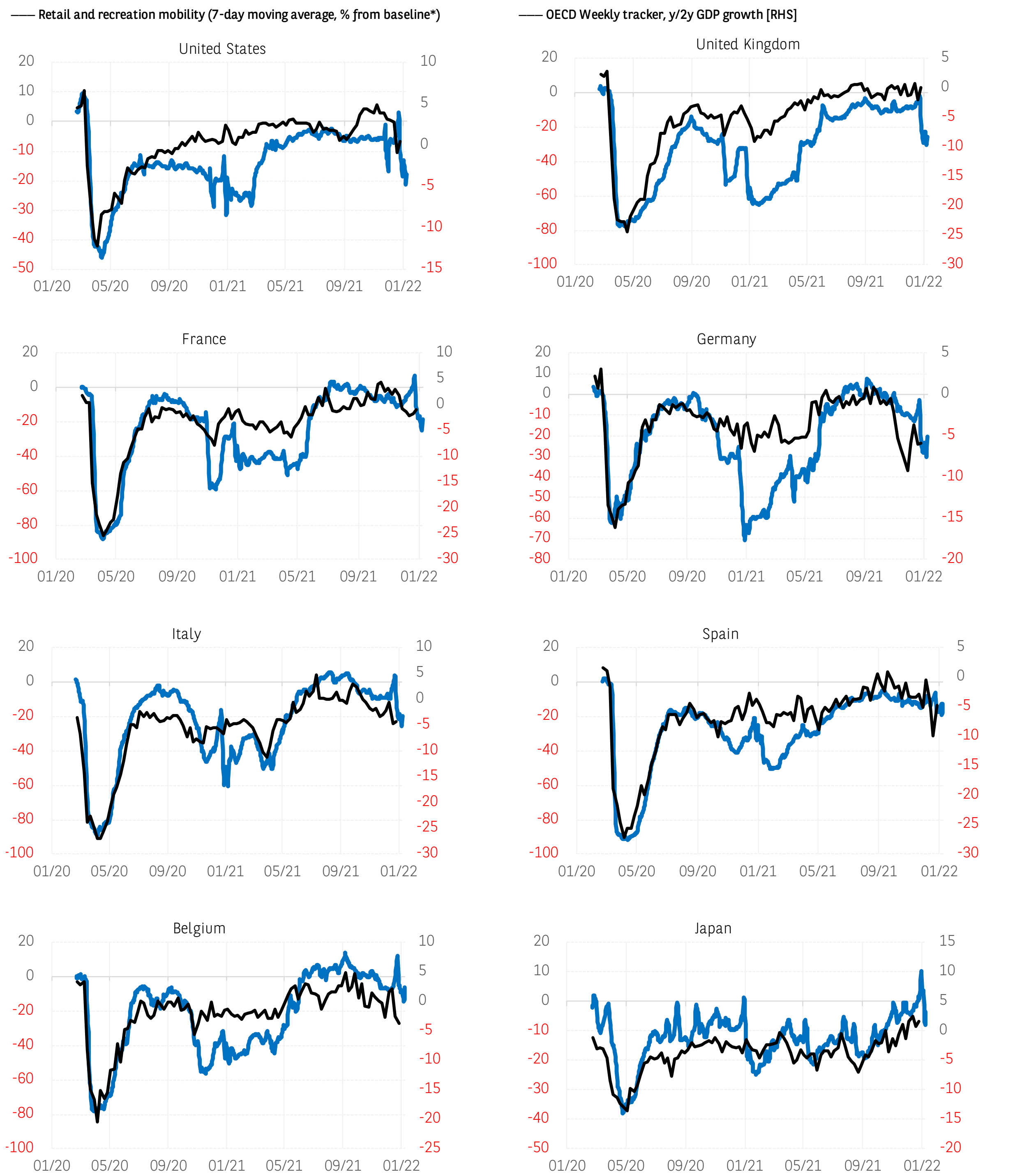


CHART 2 SOURCE: OUR WORLD IN DATA (01/13/2022), BNP PARIBAS

RETAIL AND RECREATION MOBILITY & OECD WEEKLY TRACKER

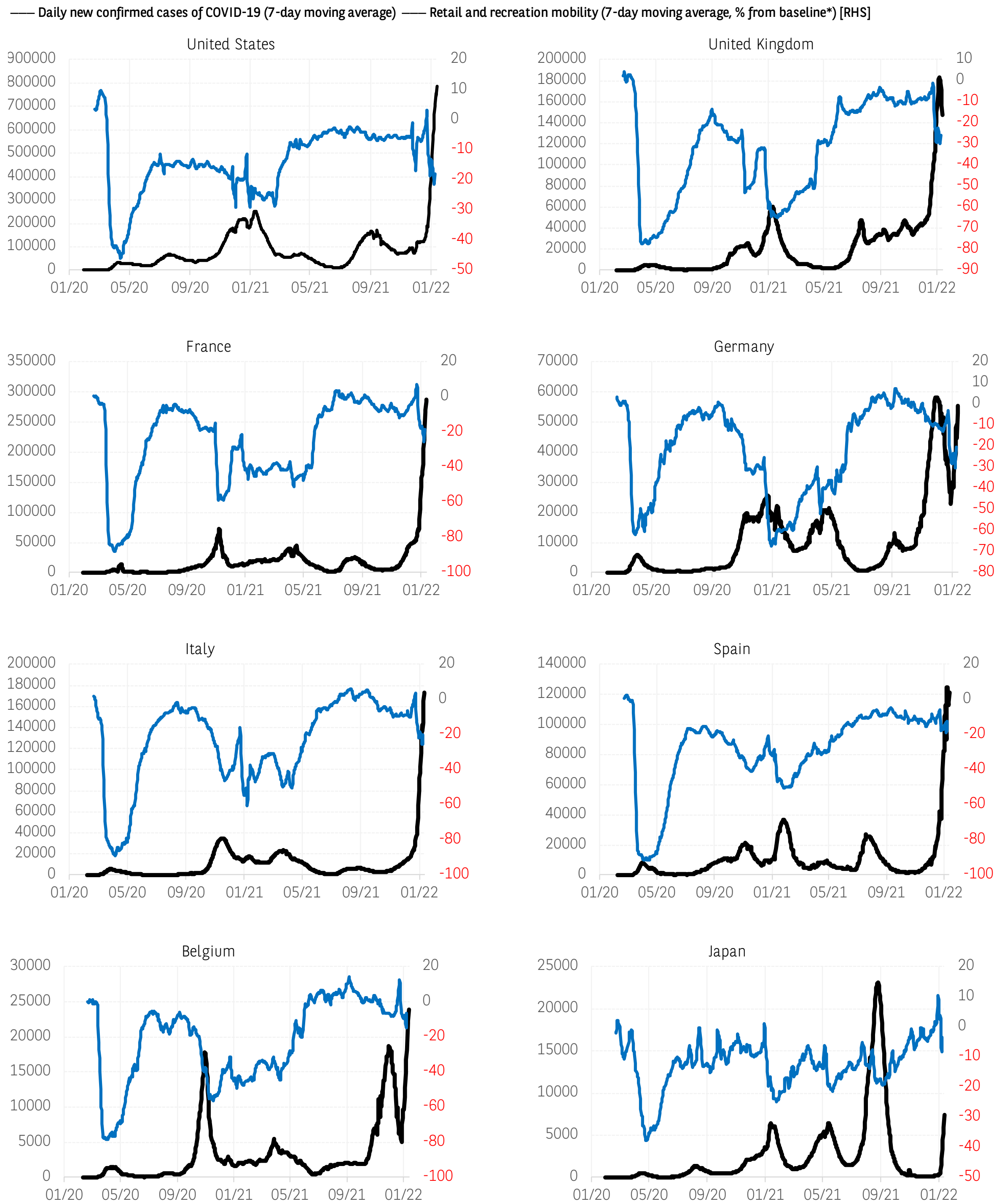
Retail and recreation mobility (7-day moving average, % from baseline*) OECD Weekly tracker, y/2y GDP growth [RHS]



SOURCE: OECD (01/06/2022), GOOGLE (01/13/2022), 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: UNIVERSITE DE JOHNS-HOPKINS (01/13/2022), GOOGLE (01/13/2022), BNP PARIBAS

ECONOMIC SCENARIO

UNITED STATES

Albeit in a rather uneven manner, the US economy has bounced back swiftly from the Covid-19 pandemic and is now stronger than in 2019. Its growth rate, at 5.5% in 2021, is likely to return gradually to normal. Longer and stronger than expected, the upturn in inflation is also likely to ease, if only due simply to the basis of comparison (once prices stop being compared to their depressed levels of 2020). The return towards the 2% target could, however, be hampered by rising prices for services, particularly rents. The situation in the labour market has improved: with a rising activity rate and unemployment dropping significantly below 5% of the active population, the economy is approaching full employment.

CHINA

Economic growth has slowed markedly since last summer. Export performance remains strong and supports manufacturing investment. However, the other components of domestic demand are constrained by a host of factors: the effects of the H1 tightening in fiscal policy and domestic credit conditions, the toughening of regulations in various services, the crisis in the property sector, supply constraints in the industry, and the resurgence of the epidemic. In the short term, industrial production growth should recover. Moreover, the authorities should increase their support to domestic activity through prudent monetary and fiscal policy measures, while continuing regulatory tightening and maintaining their objective of rebalancing the real estate market. The contraction in housing sales and the "zero covid" strategy should continue to weigh on private consumption.

EUROZONE

Growth in the eurozone remained strong in Q3 2021, in line with expectations (2.2% q/q). However, the outlook for Q4 is much less bright. According to our most recent forecast dated 25 November, we expect growth to slow down to 0.4% q/q. In addition to the awaited normalization, headwinds have increased (supply-side problems, surging inflation and uncertainties arising from the new wave of the pandemic). Nevertheless, business conditions surveys have shown resilience so far. Although the downside risks have increased, our scenario for 2022 remains fairly optimistic. This is because there is no shortage of tailwinds – supportive policy mix, a build-up of forced savings, scope for the service sector to catch-up, the need for companies to invest and rebuild inventories – assuming that supply-side problems ease from the second half of the year. Above all, growth will remain well above its trend rate in 2022. We also expect it to be not much lower than its 2021 figure (4.2% versus 5%). Compared with our September scenario, we have cut our growth forecasts and raised our inflation forecasts, taking the view that behind the current temporary pressures on prices, more sustained and widespread factors are also at play. We expect average inflation to be higher in 2022 than in 2021 (3.1% versus 2.5%), although we see inflation falling over the course of next year.

FRANCE

What is happening at the aggregate eurozone level is representative of what is happening in France, and vice-versa. Although the figures are different, our analysis and view of the economic outlook are identical. In Germany, the headwinds are stronger, while France is less exposed. French growth was strong in Q3 2021 – beating expectations at 3% q/q according to INSEE's initial estimate – but we expect it to slow to 0.6% q/q in Q4. In 2022, we anticipate growth of 4.2% in annual average terms (vs. 6.7% in 2021) and inflation of 2.5% (vs. 2%).

RATES AND EXCHANGE RATES

In the US, the Federal Reserve has started tapering and this should lead to net asset purchases ending in March this year. The tone of the minutes of the December meeting of the FOMC was hawkish. Given current particularly elevated inflation, the inflation outlook and the strength of the labour market, as reflected in the unemployment rate that has dropped below 4.0%, we expect a first rate hike in March, followed by three additional hikes in 2022 and four more in 2023. In addition, we expect the reduction of the balance sheet (quantitative tightening) to start in August this year. This should put upward pressure on Treasury yields.

In the eurozone, the ECB has announced in December that it will stop net purchases under the PEPP in March 2022. On that occasion, the monthly volume under the traditional asset purchase program will be increased temporarily to avoid market disruption. Given the strength of the recovery, we expect underlying price pressures to build further. We expect that the ECB will hike its deposit rate in June 2023, considering that by then the three conditions for a rate hike would be met. Two additional hikes should follow in the second half of 2023. This, in combination with the influence from higher US Treasury yields, should lead to higher Bund yields and some widening of sovereign spreads.

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 about 20bp, which is in the upper end 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	5,5	4,7	2,8	4,7	4,6	2,1
Japan	1,7	2,6	1,6	-0,2	0,7	0,5
United-Kingdom	7,1	5,4	2,1	2,5	4,5	2,1
Euro Area	5,0	4,2	3,0	2,5	3,1	2,0
Germany	2,6	3,6	3,6	3,1	3,4	2,2
France	6,7	4,2	2,5	2,0	2,5	2,1
Italy	6,3	4,9	3,0	1,8	2,9	1,7
Spain	4,3	5,4	3,5	3,0	3,7	1,7
China	7,9	5,3	5,5	0,9	2,1	2,5
India*	8,0	11,0	6,0	5,4	5,7	5,0
Brazil	4,8	0,5	2,0	8,3	8,3	4,3
Russia	4,5	3,0	1,8	7,0	6,3	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		Q1 2022 e	Q2 2022 e	Q3 2022 e	Q4 2022 e	Q4 2023 e
US	Fed Funds (upper limit)	0.50	0.75	1.00	1.25	2.25
	T-Note 10y	1.70	1.80	1.90	2.00	2.30
Ezone	Deposit rate	-0.50	-0.50	-0.50	-0.50	-0.10
	Bund 10y	0.00	0.05	0.05	0.10	0.40
	OAT 10y	0.45	0.40	0.35	0.45	0.70
	BTP 10y	1.35	1.45	1.45	1.55	2.00
	BONO 10y	0.75	0.85	0.90	1.05	1.45
UK	Base rate	0.25	0.50	0.50	0.75	1.25
	Gilts 10y	1.10	1.20	1.30	1.45	1.75
Japan	BoJ Rate	-0.10	-0.10	-0.10	-0.10	-0.10
	JGB 10y	0.12	0.14	0.15	0.18	0.20

Exchange Rates						
End of period		Q1 2022 e	Q2 2022 e	Q3 2022 e	Q4 2022 e	Q4 2023 e
USD	EUR / USD	1.13	1.12	1.11	1.09	1.09
	USD / JPY	115	116	117	118	120
	GBP / USD	1.35	1.35	1.35	1.33	1.36
EUR	EUR / GBP	0.84	0.83	0.82	0.82	0.80
	EUR / JPY	130	130	130	129	131

Brent						
End of period		Q1 2022 e	Q2 2022 e	Q3 2022 e	Q4 2022 e	Q4 2023 e
Brent	USD/bbl	84	80	79	80	85

SOURCE: BNP PARIBAS GLOBAL MARKETS (E: ESTIMATES)

CALENDAR

LATEST INDICATORS

In Japan, the Eco Watchers Survey showed stability in the assessment of the current situation but the outlook worsened and declined far more than anticipated. In China, producer price inflation slowed significantly and more than expected, although at 10.3%, it remains very high. Consumer price inflation saw a large decline, to 1.5%. The Banque de France industrial sentiment index recorded an unexpected and big improvement. In the US, monthly consumer price inflation edged higher to 0.6% and annual core inflation also rose, to 5.5%. The situation is even worse for headline inflation, which has reached 7.0%. Annual producer price inflation also moved higher but eased on a monthly basis. In the UK, the monthly estimate of GDP growth jumped in November, beating expectations by a wide margin. The Federal Reserve's Beige Book reported robust wage growth nationwide and solid growth in prices charged to customers. In the US, retail sales contracted significantly and unexpectedly in December and University of Michigan sentiment declined more than anticipated, both in terms of the assessment of current conditions and the expectations component. Inflation expectations -both one year and five to ten year- edged higher.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	ACTUAL	PREVIOUS
01/10/2022	Eurozone	Unemployment Rate	Nov	7.2%	7.2%	7.3%
01/11/2022	United States	NFIB Small Business Optimism	Dec	98.7	98.9	98.4
01/11/2022	France	Bank of France Ind. Sentiment	Dec	104.0	108.0	106.0
01/12/2022	China	PPI YoY	Dec	11.3%	10.3%	12.9%
01/12/2022	China	CPI YoY	Dec	1.7%	1.5%	2.3%
01/12/2022	Japan	Eco Watchers Survey Outlook SA	Dec	52.0	49.4	53.4
01/12/2022	Japan	Eco Watchers Survey Current SA	Dec	56.0	56.4	56.3
01/12/2022	United States	CPI MoM	Dec	0.4%	0.5%	0.8%
01/12/2022	United States	CPI Ex Food and Energy MoM	Dec	0.5%	0.6%	0.5%
01/12/2022	United States	CPI YoY	Dec	7.0%	7.0%	6.8%
01/12/2022	United States	CPI Ex Food and Energy YoY	Dec	5.4%	5.5%	4.9%
01/12/2022	United States	U.S. Federal Reserve Releases Beige Book				7.9%
01/13/2022	United States	PPI Ex Food and Energy YoY	Dec	8.0%	8.3%	9.8%
01/13/2022	United States	PPI Final Demand YoY	Dec	9.8%	9.7%	0.9%
01/13/2022	United States	PPI Ex Food and Energy MoM	Dec	0.5%	0.5%	1.0%
01/13/2022	United States	PPI Final Demand MoM	Dec	0.4%	0.2%	0.8%
01/13/2022	United States	Initial Jobless Claims	Jan	200k	230k	207k
01/14/2022	United Kingdom	Monthly GDP (MoM)	Nov	0.4%	0.9%	0.2%
01/14/2022	United Kingdom	Monthly GDP (3M/3M)	Nov	0.8%	1.1%	0.9%
01/14/2022	France	CPI EU Harmonized MoM	Dec	0.2%	0.2%	0.2%
01/14/2022	France	CPI EU Harmonized YoY	Dec	3.4%	3.4%	3.4%
01/14/2022	United States	Retail Sales Advance MoM	Dec	-0.1%	-1.9%	0.2%
01/14/2022	United States	Retail Sales Control Group	Dec	0.0%	-3.1%	-0.5%
01/14/2022	United States	Capacity Utilization	Dec	77.0%	76.5%	76.6%
01/14/2022	United States	U. of Mich. Sentiment	Jan	70.0	68.8	70.6
01/14/2022	United States	U. of Mich. Current Conditions	Jan	73.8	73.2	74.2
01/14/2022	United States	U. of Mich. Expectations	Jan	67.0	65.9	68.3
01/14/2022	United States	U. of Mich. 1 Yr Inflation	Jan	4.8%	4.9%	4.8%
01/14/2022	United States	U. of Mich. 5-10 Yr Inflation	Jan	--	3.1%	2.9%

SOURCE: BLOOMBERG

CALENDAR: THE WEEK AHEAD

COMING INDICATORS

As usual around this time of the month, several data will be released in China. In addition we will also have GDP growth for the fourth quarter of 2021. In the UK, we will see the publication of labour market data, inflation, house prices, consumer confidence and retail sales. The ZEW survey will be published for Germany. For the euro area we will have the same survey, the final inflation numbers for December and consumer confidence. In France, business confidence data will be released. Housing market data will be published in the US. Finally, the Bank of Japan will hold its monetary policy meeting.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	PREVIOUS
01/17/2022	China	Property Investment YTD YoY	Dec	5.20%	6.00%
01/17/2022	China	Industrial Production YTD YoY	Dec	9.60%	10.10%
01/17/2022	China	Industrial Production YoY	Dec	3.80%	3.80%
01/17/2022	China	Fixed Assets Ex Rural YTD YoY	Dec	4.80%	5.20%
01/17/2022	China	GDP YTD YoY	4Q	8.00%	9.80%
01/17/2022	China	GDP SA QoQ	4Q	1.20%	0.20%
01/17/2022	China	GDP YoY	4Q	3.60%	4.90%
01/17/2022	China	Retail Sales YTD YoY	Dec	12.70%	13.70%
01/17/2022	China	Retail Sales YoY	Dec	3.80%	3.90%
01/17/2022	China	Surveyed Jobless Rate	Dec	5.00%	5.00%
01/18/2022	United Kingdom	Weekly Earnings ex Bonus 3M/YoY	Nov	--	4.30%
01/18/2022	United Kingdom	ILO Unemployment Rate 3Mths	Nov	--	4.20%
01/18/2022	United Kingdom	Employment Change 3M/3M	Nov	--	149k
01/18/2022	Germany	ZEW Survey Expectations	Jan	--	29.9
01/18/2022	Germany	ZEW Survey Current Situation	Jan	--	-7.4
01/18/2022	Eurozone	ZEW Survey Expectations	Jan	--	26.8
01/18/2022	United States	NAHB Housing Market Index	Jan	84	84
01/18/2022	Japan	BOJ Policy Balance Rate	Jan	--	-0.10%
01/19/2022	United Kingdom	CPI YoY	Dec	--	5.10%
01/19/2022	United Kingdom	CPI Core YoY	Dec	--	4.00%
01/19/2022	United Kingdom	House Price Index YoY	Nov	--	10.20%
01/19/2022	United States	Building Permits MoM	Dec	-0.40%	3.60%
01/19/2022	United States	Housing Starts MoM	Dec	-1.10%	11.80%
01/20/2022	France	Business Confidence	Jan	--	110
01/20/2022	Eurozone	CPI YoY	Dec	--	4.90%
01/20/2022	Eurozone	CPI MoM	Dec	--	0.40%
01/20/2022	Eurozone	CPI Core YoY	Dec	--	2.60%
01/20/2022	United States	Initial Jobless Claims	Jan	--	--
01/20/2022	United States	Philadelphia Fed Business Outlook	Jan	21	15.4
01/20/2022	United States	Existing Home Sales	Dec	6.45m	6.46m
01/20/2022	United States	Existing Home Sales MoM	Dec	-0.20%	1.90%
01/20/2022	United Kingdom	GfK Consumer Confidence	Jan	--	-15
01/20/2022	United Kingdom	Retail Sales Ex Auto Fuel MoM	Dec	--	1.10%
01/20/2022	Eurozone	Consumer Confidence	Jan	--	-8.3

SOURCE: BLOOMBERG

FURTHER READING

US: monetary policy at a turning point	EcoTVWeek	14 January 2022
US: The Bank of Japan is the main counterparty in the Fed's FRRP facility	Chart of the Week	12 January 2022
French Economy Pocket Atlas - January issue	Pocket Atlas	11 January 2022
Global: Supply side disruption, some hopeful signs	EcoWeek	10 January 2022
Euros in our pockets: looking back, looking ahead	EcoTVWeek	7 January 2022
European Union : New year, new fiscal rules for Europe?	Chart of the Week	5 January 2022
Global: 2022: assessing upside and downside risks	EcoWeek	3 January 2022
Economic analyses and economic forecasts for a selection of countries.	EcoPerspectives	17 December 2021
Beyond interest rates: the role of fiscal, financial and monetary conditions	EcoTVWeek	17 December 2021
Portugal : Non-performing loans remain stable despite moratoria coming to an end	Chart of the Week	15 December 2021
The monetary policy dichotomy in emerging economies	EcoFlash	14 December 2021
Fiscal policy to continue to support euro area growth next year	EcoWeek	13 December 2021
Greece: encouraging trends	EcoTVWeek	10 December 2021
Signs of a decline in globalization	Chart of the Week	9 December 2021
Three headwinds to growth	EcoWeek	6 December 2021
US: PPP government-guaranteed loans are largely converted into public subsidies	EcoTVWeek	3 December 2021
US: The Fed, the new preferred repo counterparty in times of tension	EcoFlash	2 December 2021
Egypt: persistent vulnerabilities	EcoConjoncture	1 December 2021
Turkey: New financial tensions	Chart of the Week	1 December 2021
High inflation, optionality and central bank patience	EcoWeek	29 November 2021

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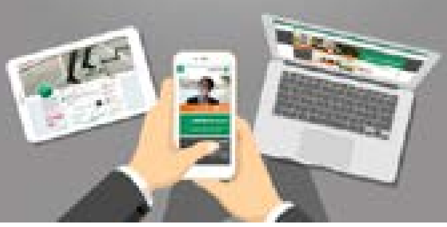

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