

ECONOMIC SCENARIO

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UNITED STATES

The U.S. economy continued to grow in Q4, although it slowed slightly compared to Q3. The determinants of growth, namely household consumption and private inventories, are fragile, suggesting that the economy should continue to slow. The labour market is showing very early signs of a slowdown, but job creation remains high, the unemployment rate is still low and wages are still buoyant. Inflation seems to have peaked in the middle of the year and should continue to fall while remaining significantly above the target of 2% by late 2023. Following the mid-term elections, the Democrats retained a narrow majority in the Senate and the Republicans won a very tiny majority in the House of Representatives. This should limit what President Joe Biden can do over the remainder of his term, but, at the same time, compromises could also be reached.

CHINA

The recovery in Chinese economic growth since its Q2 2022 contraction has been sluggish and unbalanced. Industrial production has been the main growth driver, but it has lost steam since last October, largely due to the weakening in external demand and slower export growth. Meanwhile, activity driven by the domestic market and the services sector remains constrained by powerful drags, including the crisis in the property sector, the deterioration in the labour market, weak household confidence, and the Covid policy. Since early December 2022, the very sudden and ill-prepared abandonment of the strict zero Covid policy has plunged the country into new turbulence. However, domestic demand should rebound when the epidemic wave starts to ease. The authorities are enhancing again fiscal and monetary support measures, which are notably aimed at stabilizing the property sector.

EUROZONE

Growth in the euro zone in the third quarter was weak, but at least it remained positive, while the survey data (business and consumer confidence) seemed to be clearly pointing to a decline. Although a contraction was avoided in the third quarter, the euro zone is unlikely to avoid recession. The combination of the inflationary shock, the energy crisis and the enforced monetary tightening and their increasingly negative effects are likely to overcome the resistance seen to date. However, the recession should remain shallow thanks to the fiscal policy cushion and the current tightness of the labour market. In annual average terms, real GDP growth in the euro zone is expected to reach 3.4% in 2022 and 0.2% in 2023. The subsequent recovery is likely to be weak. Inflation is likely to remain elevated, well above the 2% target at the end of this year and only falling back to it at the end of 2024, which will keep monetary policy in restrictive territory.

FRANCE

Real GDP growth has continued during the 3rd quarter (0.2% q/q, after +0.5% during the 2nd quarter), driven by a growth of manufacturing production partly explained by a recovery of sectors exposed to supply-side problems (particularly the car sector) and partly related to growing inventories in order to avoid potential stronger constraints on production during the winter. This element should weigh on Q4 GDP growth, which should also suffer from the ongoing inflation acceleration (from 5.9% y/y in December towards 6.5% in February, before a gradual disinflation). These shocks should weigh on GDP growth in 2023 (0% according to our forecasts, after 2.5% in 2022).

RATES AND EXCHANGE RATES

In the US, the Federal Reserve will continue its tightening policy, bringing the federal funds rate to its terminal rate for this cycle at 5.25% (upper end of the target range) in the first half of this year. Given the expected slow decline in inflation and despite the economy entering recession, this level should be maintained through 2023 and only be followed by rate cuts in 2024. US Treasuries are largely pricing in the upcoming rate hikes. In the near term there is still some upward potential, but subsequently yields should move lower as the inflation outlook improves and the market starts anticipating policy easing in 2024.

The ECB Governing Council will continue to raise its policy rates at its next meetings. We expect the terminal rate -i.e. the peak rate in this cycle- to be reached by the end of the first half of this year. We expect a peak for the deposit rate at 3.25%. We expect quantitative tightening to start in the second quarter of 2023. Early on in 2023, we expect higher government bond yields on the back of important supply but thereafter yields should move lower, driven by a gradual decline in inflation. Lower US yields should also play a role in the decline of eurozone yields.

The Bank of Japan has increased the upper end of its target range for the 10-year JGB yield to 0.5% and further adjustments to the yield curve control policy cannot be excluded. Nevertheless, we do not expect the BoJ to proceed with a rate hike.

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 increased policy divergence between the Fed and the Bank of Japan. We expect the exchange rate to remain around current levels in the near term. In 2023, the yen should strengthen versus the dollar considering that the federal funds rate should have reached its terminal rate.

GDP GROWTH AND INFLATION

| % | GDP Growth | | | | Inflation | | | |
|----------------|------------|--------|--------|--------|-----------|--------|--------|--------|
| | 2021 | 2022 e | 2023 e | 2024 e | 2021 | 2022 e | 2023 e | 2024 e |
| United-States | 5,7 | 2,1 | 0,7 | 0,2 | 4,7 | 8,1 | 4,2 | 2,4 |
| Japan | 1,7 | 1,2 | 0,9 | 0,3 | -0,2 | 2,5 | 2,2 | 1,2 |
| United-Kingdom | 7,4 | 4,4 | -0,9 | 0,8 | 2,6 | 9,0 | 6,8 | 2,1 |
| Euro Area | 5,3 | 3,4 | 0,2 | 1,3 | 2,6 | 8,4 | 5,0 | 2,4 |
| Germany | 2,6 | 1,9 | -0,2 | 1,2 | 3,2 | 8,6 | 4,6 | 2,1 |
| France | 6,8 | 2,5 | 0,0 | 1,0 | 2,1 | 5,9 | 5,8 | 2,9 |
| Italy | 6,6 | 3,9 | 0,2 | 1,2 | 1,9 | 8,7 | 6,7 | 2,3 |
| Spain | 5,1 | 5,3 | 0,6 | 1,4 | 3,0 | 8,3 | 1,8 | 1,7 |
| China | 8,1 | 3,0 | 5,1 | 5,3 | 0,9 | 2,0 | 2,7 | 2,5 |
| India* | 9,3 | 8,3 | 6,2 | 6,5 | 5,4 | 7,9 | 5,9 | 5,5 |
| Brazil | 4,6 | 3,0 | 0,5 | 1,3 | 8,3 | 9,4 | 5,4 | 4,9 |
| 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 AND EXCHANGE RATES

| Interest rates, % | | Q1 2023 | Q2 2023 | Q3 2023 | Q4 2023 | Q4 2024 |
|-------------------|-------------------------|---------|---------|---------|---------|---------|
| End of period | | | | | | |
| US | Fed Funds (upper limit) | 5.00 | 5.25 | 5.25 | 5.25 | 3.25 |
| | T-Note 10y | 4.30 | 4.00 | 3.75 | 3.50 | 3.25 |
| Eurozone | deposit rate | 3.00 | 3.25 | 3.25 | 3.25 | 2.00 |
| | Bund 10y | 2.75 | 2.65 | 2.50 | 2.30 | 2.00 |
| | OAT 10y | 3.45 | 3.30 | 3.10 | 2.90 | 2.50 |
| | BTP 10y | 5.25 | 5.05 | 4.80 | 4.60 | 3.80 |
| UK | BONO 10y | 4.05 | 3.90 | 3.75 | 3.55 | 2.90 |
| | Base rate | 4.25 | 4.25 | 4.25 | 4.25 | 3.50 |
| Japan | Gilts 10y | 4.00 | 3.75 | 3.60 | 3.35 | 3.15 |
| | BoJ Rate | -0.10 | -0.10 | -0.10 | -0.10 | -0.10 |
| | JGB 10y | 0.90 | 0.95 | 0.95 | 0.90 | 0.90 |

| Exchange Rates | | Q1 2023 | Q2 2023 | Q3 2023 | Q4 2023 | Q4 2024 |
|----------------|-----------|---------|---------|---------|---------|---------|
| End of period | | | | | | |
| USD | EUR / USD | 1.01 | 1.00 | 1.03 | 1.06 | 1.10 |
| | USD / JPY | 140 | 138 | 133 | 128 | 120 |
| | GBP / USD | 1.09 | 1.08 | 1.11 | 1.14 | 1.18 |
| EUR | EUR / GBP | 0.93 | 0.93 | 0.95 | 0.95 | 0.95 |
| | EUR / JPY | 141 | 138 | 137 | 136 | 132 |

| Brent | | Q1 2023 | Q2 2023 | Q3 2023 | Q4 2023 | Q4 2024 |
|---------------|---------|---------|---------|---------|---------|---------|
| End of period | | | | | | |
| Brent | USD/bbl | 95 | 93 | 95 | 92 | 95 |

SOURCES: BNP PARIBAS (E: ESTIMATES & FORECASTS) (MARKET ECONOMICS, INTEREST RATE STRATEGY, FX STRATEGY, COMMODITIES DESK STRATEGY)



BNP PARIBAS

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