ECONOMIC OUTLOOK IN THE FACE OF UNCERTAIN ELECTION OUTCOMES

Our central scenario of a Eurozone take-off and a US soft landing, confirmed by the latest available indicators, is characterised by an expected convergence in growth rates. This base case could, however, be impacted by political uncertainties on both sides of the Atlantic (uncertain outcomes of the early parliamentary elections in France and the US presidential election). Furthermore, while the ECB began its easing cycle in June, as expected, providing timely support for growth, the Fed is still holding back. This extension of the status quo, even if it seems justified for the time being, constitutes another downside risk. However, growth is benefiting from other supportive and resilient factors, chief among them real wage gains. The dynamism of tourism, the support of public policies (such as Next Generation EU in Europe and the Inflation Reduction Act (IRA) in the United States), investment in the low-carbon transition and the dissipation of the energy shock also act as tailwinds.

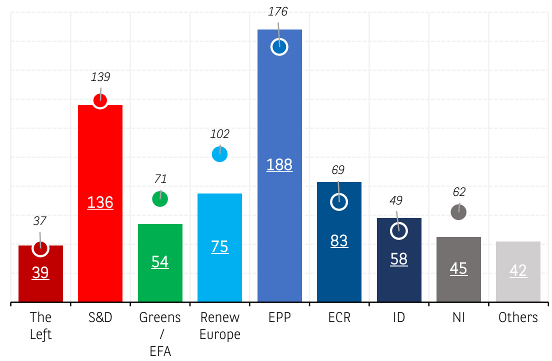
The uncertainty surrounding the outcome of the European elections, held between 6 and 9 June, has now been lifted and we know the results. But there is still significant uncertainty about the practical implications of these results for Europe's agenda. On the face of it, the composition of the new European Parliament elected for 2024-2029 has changed little overall, with the centrist parties, comprising the EPP, the S&D Group and Renew Europe, still in the majority (399 seats out of 720 according to the 27 June count, which is still provisional), albeit to a lesser extent (see chart). The strong growth of the far-right parties (ECR and ID) to the detriment of the Renew Europe Group and the Greens is the first striking feature of these elections. At this stage, it is difficult to know what the exact implications of this political reconfiguration will be for the priorities of the European agenda, and how easy or difficult it will be to reach the compromises required to continue to move this agenda forward.

At the close of the European Council of 27 June, the priorities for the next five years[1] were defined and summarized this way: "In the face of a new geopolitical reality, the strategic agenda will make Europe more sovereign and better equipped to deal with future challenges". This strategic programme is based on three pillars: a free and democratic Europe, a strong and secure Europe, and a prosperous and competitive Europe. This last point will be based in particular on the reports by Enrico Letta (on the single market), Christian Noyer (on European capital markets) and the forthcoming report by Mario Draghi (on competitiveness). The convergence in growth rates between the Eurozone and the US that we are forecasting by 2025, if it materialises, would only be a tiny step forward given the growth divide that has appeared between the two regions. It is the conditions for this leap forward that these reports seek to put in place. The EU's ambition must be to promote, in a pragmatic way, a new model of economic development that meets the climate and social challenges. The EU 27 also agreed on the reappointment of Ursula von der Leyen as President of the European Commission, an appointment that must still be approved by the European Parliament, which is due to vote on 18 July.

The second salient feature of the European elections is the political impact of their results in France. While the results were in line with the opinion polls, the surprise came from the announcement, immediately after, by President Emmanuel Macron, of the dissolution of the National Assembly and therefore of snap parliamentary elections (first round on 30 June, second round on 7 July), the outcome of which is highly uncertain.

This is the particular background to our quarterly review of the economic situation and outlook in the major OECD economies. Our central scenario is that of a take-off by the Eurozone and a soft landing by the US economy and is characterised by an expected convergence in growth rates (on a quarterly basis from Q3 2024 and

SEATS IN THE EUROPEAN PARLIAMENT 2024-2029 (PROVISIONAL RESULTS - 27 JUNE 2024 ; UNDERLINED FIGURES) VS. OUTGOING PARLIAMENT 2019-2024 (FIGURES IN ITALIC)



SOURCE: EUROPEAN PARLIAMENT, BNP PARIBAS

as an annual average in 2025). However, this baseline scenario could be derailed if the recovery underway in the Eurozone falters due to political uncertainties. Two other major uncertainties continue to represent a downside risk to US growth, primarily, but also to the rest of the world through spillover effects. These are, on the one hand, the consequences of the Fed's prolonged monetary status quo (until, possibly, a first rate cut only in December) and, on the other, the outcome of the US presidential election on 5 November.

CENTRAL SCENARIO: RESILIENT GROWTH, CONTINUED FALL IN INFLATION, MONETARY EASING AND FISCAL CONSOLIDATION

Alongside these downside risks however, there are factors supporting and bolstering growth that underpin our current central scenario. Firstly, real wage gains as inflation falls faster than the still limited moderation in wages. The following factors should also have a positive impact: the buoyancy of tourism (France will also benefit from the specific impact of the Olympic Games); the dissipation of the shock on energy prices (which has been more detrimental for the Eurozone than for the US); the reduction in the degree of monetary restriction – to quote Christine Lagarde – which has begun in the Eurozone and is still to come in the US; the continuing strength of the labour market; and the considerable and urgent need for investment in the low-carbon transition.

1 2024_557_new-strategic-agenda.pdf (europa.eu), 27 June 2024.

It is also worth noting the support of public policies (NGEU and all its variants for Europe[2] ; the Infrastructure, Investment and Jobs Act, the CHIPS Act and the Inflation Reduction Act in the US).

In addition, a central element of our scenario of converging growth rates in the Eurozone and the US is the expected (moderate) upturn in household consumption on this side of the Atlantic (and the potential represented by their accumulated excess savings, which are still increasing according to the latest ECB estimates[3]) and the slowdown in consumption of US households (which have already drawn extensively on their savings).

However, fiscal consolidation is a headwind that must be taken into account. And this is not a risk: this consolidation is certain as it is necessary, on both sides of the Atlantic. In Europe, the fiscal rules are back in force, and twelve countries have been identified as not meeting the deficit criterion, which is a prerequisite for launching an excessive deficit procedure[4]. The uncertainty relates to the nature and scope of this upcoming fiscal consolidation and, in the current political context, it comes with another element of risk: will this consolidation happen in an orderly way or not? We will remember, however, as the Banque de France emphasises with regard to France (although this applies to all countries) that «the upcoming period of gradual recovery and monetary easing is not unfavourable to the necessary fiscal recovery needed to bring public debt under control»[5] . In other words, this is the right time to make a measured counter-cyclical fiscal adjustment.

Inflation remains closely monitored, particularly whether the wages-margins-productivity triangle evolves in the expected way (moderation of the first, compression of the second and recovery of the latter). But inflation looks to be a bit less of a concern compared to a few months ago as the disinflation process continues, and the target of 2% is nonetheless moving closer, albeit still slowly[6] .

OUTLOOK BY REGION

From our point of view, the uncertainties surrounding our central scenario tend to be more on the downside at the time of writing. In any case, there is heightened uncertainty over whether the Eurozone will continue to take off. The latest business climate surveys for June have been blowing quite cold[7]. That said, the Eurozone cyclical situation remains positive for the time being. Until the beginning of June, the overall economic picture was looking better. Our nowcast estimates Q2 growth at +0.3% q/q, the same rate as in Q1. This perception of an improved situation is fairly common to the various countries in the Eurozone examined in this publication (Germany, France, Italy, Spain, the Netherlands, Belgium, Greece, Austria), without obscuring certain sectoral difficulties (the real estate market) and structural challenges (productivity, competitiveness in the face of increased competition) that remain and are hampering the recovery.

Elsewhere in Europe, the UK is also facing an important political outcome, with the general election to be held on 4 July. The winning party will take over the reins of a flagging economy, which is struggling a little more than the Eurozone (Eurozone GDP, for example, is just over 3% above its pre-Covid level of Q4 2019, while that of the UK is just under 2% above this benchmark). Denmark, on the other hand, stands out with a more dynamic economy (GDP 9% above its pre-pandemic level), buoyed by the performance of the pharmaceutical sector – a double-edged sword of dependence, however.

In the US, while there are also negative or more mixed economic signals, suggesting that the economic slowdown could become more pronounced, the PMI indices for June were positive. Developments in the labour market are being closely monitored. For the time being, its slowdown is seen as a welcome rebalancing, in line with the Fed's desired objective, but fears of a more marked deterioration in the making are on the rise. On the other side of the Pacific, in Japan, it is the weakness of the yen that is attracting attention, as the Japanese currency continues to be penalised by the monetary policy differential between the Fed (which is delaying its rate cuts) and the BoJ (which is nonetheless raising them, against the tide of most other central banks, but very cautiously). As for China, the country's economic performance remains mixed, buoyed by the dynamism of the manufacturing sector (exports, investment) but tarnished by trade tensions and the never-ending property crisis, which is weighing on domestic demand.

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2 For an overview of Europe's multiple responses to current crises and challenges, see Europe on the front line: A review of its climate action and economic support, 6 May 2024.
3 See chart on page 7 of Isabel Schnabel's presentation of 23 June 2024: The ECB's monetary policy: towards price stability (europa.eu). For the ECB's approach and definition of excess savings, see: Excess savings: To spend or not to spend (europa.eu), 2 November 2023.
4 Belgium, Czechia, Estonia, Spain, France, Italy, Hungary, Malta, Poland, Slovenia, Slovakia, Finland (1d91e302-b9cc-4b54-988a-9e6787230152_en (europa.eu), 19 June 2024.
5 Macroeconomic projections – June 2024 | Banque de France (banque-france.fr), 11 June 2024.
6 See Inflation Tracker – June 2024 | An improvement in real wages , 20 June 2024.
7 For more details on these latest figures, see Eco Week, Heightened uncertainty is weighing on the prospect of converging growth rates between the eurozone and the US , 25 June 2024.