

ECONOMIC SCENARIO

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UNITED STATES

After a strong second half of 2022 (+0.7% q/q on average per quarter), US activity decelerated only slightly in the first half of 2023 (+0.5% q/q on average per quarter), thanks to the resilience of household consumption and the strength of nonresidential investment. The impact of the tighter monetary policy on lending standards is strong but still limited on activity and employment growth. We still expect a shallow recession but shorter than before considering that growth no longer should be modestly positive in Q3 this year. While the peak in inflation was reached in mid-2022, core disinflation remains gradual and headline inflation should not approach the 2% target before the end of 2024. The slow pace of disinflation argues in favor of keeping monetary policy in restrictive territory, despite the expected start of the easing cycle in spring 2024. This should limit the recovery in 2024.

CHINA

Economic growth, which was sluggish and unbalanced in 2022, started to accelerate in early 2023 following the end of the zero Covid policy. However, the post-Covid recovery has lost momentum very rapidly. Export momentum has stalled due to weak global demand and tensions with the US. Domestic demand remains held back by a significant loss in consumer and investor confidence. The crisis in the property sector is persisting, with the continued fall in sales, new defaults of developers and growing difficulties of certain financial institutions. The government and the central bank implement new policy stimulus measures, which yet remain of moderate magnitude. The weak financial situation of local governments should constrain public investment.

EUROZONE

The euro zone came close to technical recession at the turn of 2022-2023. After a slight contraction in GDP in Q4 2022, growth is now estimated to be zero (rather than slightly negative) in Q1 2023. There was a technical rebound in Q2 (+0.3% q/q) that masked a disparate performance between Member States, which tends to weaken the overall result. France and Spain have been doing well, but Germany, Italy and the Netherlands are struggling. The negative effects of monetary tightening should intensify causing growth to fall back. After three quarters of stagnation, a limited recovery would follow. Although it is expected to decline throughout 2023, inflation would remain elevated and well above the 2% target at the end of this year and still a bit above at the end of 2024, forcing monetary policy to remain in restrictive territory.

FRANCE

French growth surprised on the upside in Q2 2023, with activity accelerating more than expected (+0.5% q/q, after two quarters at +0.1%). While household consumption and investment remain depressed, this rebound has been supported by business investment and, above all, exports. A negative correction is likely in Q3. Inflation keeps falling but slowly so (5.1% y/y according to the harmonized measure in July, down 2.2 points from its February peak). Because of rising interest rates, household demand should remain subdued in 2023, weighing on our GDP growth forecast (0.8% in 2023, compared to 2.6% in 2022).

RATES AND EXCHANGE RATES

In the US, after having skipped the June meeting, the Federal Reserve proceeded, as expected, to a further 25bp rate hike in July. This increase would be the last in our view, but uncertainty remains given the still elevated core inflation and the resilience of the labour market to date. In any case, these factors argue against a rate cut before the beginning of 2024. The residual uncertainty on the policy rate peak is reflected in long-term rates, which remained on an upward trend at the end of August. As inflation falls further and the prospect of monetary easing in 2024 rises, long-term rates should resume their decline soon.

Unlike the Fed, the ECB did not pause in June but, like the Fed, it increased its key rates by 25bp in July (deposit rate at 3.75%, refinancing rate at 4.25%). We are of the view that this increase would mark the end of the ECB's tightening cycle, considering the effects of the monetary tightening already underway. But it is not yet certain that it will be the last, given the absence of a tangible fall at this stage of core inflation. As part of its

monetary tightening, the ECB also announced a complete halt, starting in July 2023, of its reinvestments under the APP. European long-term rates move in line with US rates, but in a more muted way: their slight rise in late August should not last long and be followed by a gradual decline, fueled by the expected fall in core inflation which should step by step become more visible.

On 27 July, the Bank of Japan (BoJ) adjusted its yield curve control policy (YCC) by allowing a wider fluctuation in 10-year sovereign interest rates around the target of 0.5%. Further adjustments to the YCC cannot be excluded, given that the country currently faces the fastest rate of inflation since the early 1990s. Nevertheless, the BoJ is unlikely to increase its policy rates this year, but a rise is expected in 2024.

We expect the dollar to weaken somewhat versus the euro. The dollar's valuation is expensive and next year the Federal Reserve should ease earlier and more than the ECB. We expect the yen to remain around current levels in the near term before strengthening versus the dollar based on the expected monetary divergence between the Fed and the BoJ in 2024.

GDP GROWTH AND INFLATION

%	GDP Growth*				Inflation**			
	2021	2022	2023 e	2024 e	2021	2022	2023 e	2024 e
United-States	5.9	2.1	1.9	0.3	4.7	8.0	4.1	2.5
Japan	2.2	1.0	2.0	0.9	-0.2	2.5	3.2	2.3
United-Kingdom	7.6	4.1	0.5	0.1	2.6	9.0	7.5	2.9
Euro Area	5.3	3.4	0.5	0.6	2.6	8.4	5.7	3.0
Germany	2.6	1.9	-0.2	0.4	3.2	8.6	6.2	2.9
France	6.8	2.6	0.8	0.6	2.1	5.9	5.7	2.7
Italy	7.0	3.8	0.9	0.8	1.9	8.7	6.2	2.3
Spain	5.5	5.5	2.4	1.5	3.0	8.3	3.6	3.1
China	8.4	3.0	5.3	4.8	0.9	2.0	0.5	2.0
India***	8.7	7.2	6.1	6.5	5.5	6.7	5.5	4.5
Brazil	5.0	2.9	2.5	1.8	8.3	9.3	4.7	4.0

Source : BNP Paribas (e: Estimates & forecasts)

Last update: 25 August 2023

*** Fiscal year from 1st April of year n to March 31st of year n+1

INTEREST AND EXCHANGE RATES

Interest rates, %

End of period		Q3 2023	Q4 2023	Q4 2024
US	Fed Funds (upper limit)*	5.50	5.50	3.75
	T-Note 10y **	3.90	3.85	3.55
Eurozone	deposit rate*	3.75	3.75	3.00
	Bund 10y **	2.45	2.20	2.00
	OAT 10y	3.00	2.72	2.50
	BTP 10y	4.70	4.45	3.80
UK	BONO 10y	3.55	3.30	2.90
	Base rate*	5.50	5.50	4.00
Japan	Gilts 10y **	4.40	4.25	3.80
	BoJ Rate	-0.10	-0.10	0.25
	JGB 10y**	0.50	0.65	0.80

Exchange Rates

End of period		Q3 2023	Q4 2023	Q4 2024
USD	EUR / USD	1.10	1.12	1.18
	USD / JPY	133	130	123
	GBP / USD	1.25	1.27	1.34
EUR	EUR / GBP	0.88	0.88	0.88
	EUR / JPY	146	146	145

Brent

End of period		Q3 2023	Q4 2023	Q4 2024
Brent	USD/bbl	83	90	95

Sources: BNP Paribas (Market Economics, Interest Rate Strategy, FX Strategy, Commodities Desk Strategy)

* Deposit rate: Last update at 11 August 2023, Fed Funds : 2 June 2023, BoE rate: 11 August 2023

** Bund 10y: last update at 3 May 2023, Gilts 10y: 15 June 2023, JGB 10y: 22 June, US 10y: 5 June 2023



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