GLOBAL ECONOMY : THE YEAR HAS CHANGED, THE ECONOMIC SITUATION REMAINS MIXED

The latest economic data paint a mixed picture. In both the eurozone and the US, the signal from most confidence surveys in December is encouraging. But it is still too early to conclude to a bottoming out. Non-farm payrolls in the US remained robust in December. But the collapse of the employment component of the ISM survey in the non-manufacturing sector looks alarming. Business failures are on the rise. The economic situation also remains vulnerable to geopolitical tensions. On the other hand, there is no reason to worry about the inflation rebound in December. And the dynamics appear more favourable in the eurozone than in the US.

The global picture emanating from the cyclical data published in recent weeks remains mixed. Admittedly, the signal from most confidence surveys is slightly encouraging, especially in the euro area. Not only did the European Commission's economic sentiment indicator pick up significantly in December 2023 for the third consecutive month, but the increase was driven by all components (business sector sentiment and consumer confidence), which is not so common. The good news will also include the stabilisation in December of the Eurozone's PMI composite index (47.6), thanks to the very slight improvement in services (+0.1, to 48.8) offsetting the slight deterioration in the manufacturing sector (-0.2, to 44.4, output component), which can itself be put into perspective by the improvement in the new orders and new export orders components.

In the United States, the results of the ISM / PMI surveys are clearly divided, with a reverse evolution of the sectors depending on the survey considered. Such a divergence is not uncommon, the correlation between the two surveys is not perfect, but it results in an unclear diagnosis today: the manufacturing ISM rose significantly (+0.7, to 47.4) while the manufacturing PMI sharply fell (-1.5, to 47.9), the services PMI improved slightly (+0.6, to 51.4) while the non-manufacturing ISM plunged (-2.1, to 50.6). This leads to a slight increase in the composite PMI (which rises a bit further into the expansion zone, to 50.9) but to a sharp decrease in the composite ISM (which falls just above the expansion threshold, to 50.2). On the other hand, the signal from the December household confidence surveys is clearly and frankly positive, with a strong rise in both the Conference Board and the University of Michigan indicators.

While we welcome the stabilisation of the Eurozone's composite PMI over the past few months, as well as that of the United States, it is still premature to conclude to a bottoming out, predicting an upturn. Developments in the coming months remain uncertain. On the one hand, a recent ECB analysis suggests that a recovery in manufacturing business confidence may be possible. The analysis shows that the manufacturing sector has suffered more from monetary tightening than services[1]. Although not all of its negative effects have yet been felt, it is likely that they will diminish in the coming months, thus weighing less and less on the business climate in manufacturing.

On the other hand, given the large gap between the business climate of the two sectors and the leading nature of the manufacturing cycle, there is still a risk that services business confidence will deteriorate and catch-up the manufacturing sector (although this is not the current direction, as the business climate in services has been slightly on the rise in recent months).

News remains encouraging for US non-farm payrolls where the slowdown is still gradual. But the puncture appears more and more apparent according to other indicators, like job openings and quits which are on a clear downtrend, and the quits level is not far from returning to that prevailing before the Covid-19 pandemic. The unemployment rate is still not rising clearly but it has stopped falling since mid-2022, so that the recessive signal of the Sahm rule is not far off[2]. The collapse of just over 7 points, to 43.3 in December, in the employment component of non-manufacturing ISM is probably an outlier but still alarming.

If we continue with the list of concerning indicators, the rise in business insolvencies figures prominently[3] : for sure, this is a lagging indicator, a sign, among other things, of the past slowdown in activity, but it could also have a significant impact on the future economic situation. This latter also remains vulnerable to geopolitical tensions. As pointed out in our latest inflation tracker[4], "the disruption of maritime transport in the Red Sea is causing, at the beginning of 2024, new tensions on global freight and some indices showed a sharp increase in transport costs in the first week of January (a doubling according to the Freightos index). Without generating a shock as large as in 2021, the situation could, if it continues, fuel an increase in imported inflation in 2024."

Regarding inflation, we do not classify its rebound in December in year-on-year terms as negative indicator. In both the Eurozone and the US, this rebound was expected and is explained by less energy deflation, linked to unfavourable base effects. It masks a further decline in core inflation and a positive momentum. Headline inflation is expected to resume falling from January. However, this decline is expected to be less impressive than in 2023, as much of the way to the 2% target has already been accomplished.

1 Monetary policy and the recent slowdown in manufacturing and services (europa.eu), ECB monthly bulletin 8-2023, January 2024
2 The US economy enters a recession when the 3-month moving average of the national unemployment rate rises by 0.50 % points or more relative to its low during the previous 12 months.
3 France : une remontée des défaillances en 2023 qui s'est accentuée au 4e trimestre (bnpparibas.com), 8 January 2024 (translation available soon)
4 Inflation tracker - January 2024 | Inflation picked up in the euro area and the United States in December (bnpparibas.com), 12 January 2024

> In the US and the Eurozone, most survey data ended 2023 on a slightly encouraging note. But the outlook remains uncertain, vulnerable in particular to rising insolvencies and geopolitical tensions.

The question remains how fast the 'last mile' will be covered, which separates the current rate of around 3% from the 2% target. According to our current forecasts, the euro area would win the race, with the target being reached and breached, first in April and then, more permanently, from June onwards. In annual average terms, headline inflation would even be slightly below 2%, at 1.9% in 2024 (2.3% for core inflation). In the United States, inflation (as measured by the CPI) would still not have reached the 2% target by year-end: it would still stand at 2.5% y/y (2.7% on annual average). However, according to the Federal Reserve's preferred measure (the Personal Consumption Expenditures deflator), the target would be met at the end of the year taking into account the average 0.5 percentage point difference between the two measures.

The more favourable inflation scenario for the Eurozone explains why we expect the ECB to be the first to cut rates, in April. However, the Fed would quickly follow suit, in May, given the deterioration in the economic situation we expect to see, in addition to past and anticipated progress on the disinflation front. One can observe that, at the time of the Fed's last rate hike, in July 2023, core inflation (CPI measure) was higher than the unemployment rate (4.7% y/y and 3.5%, respectively), which is not a frequent configuration and may raise fears of a premature end to monetary tightening.

However, by the time the Fed delivers its first rate cut according to our forecasts, core inflation should be lower than the unemployment rate, legitimizing easing. Starting from a higher level of policy interest rates, the Fed would then move faster than the ECB (a 25-basis-point cut per meeting for the Fed, 6 by the end of the year, versus one per quarter for the ECB).

There is still a fair amount of uncertainty surrounding this expected rate path, well-illustrated by the volatile pricing of financial markets. Hopes of early rate cuts fueled the euphoric note on which they ended 2023. But they probably got a little too fast, and the first days of 2024 were marked by a correction and profit-taking. As mentioned in our previous editorial[5] , lower inflation paving the way for rate cuts is the only development that is relatively certain this year.

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5 Global economy - 2024: lower central bank rates and then what? (bnpparibas.com), 10 January 2024