

## GLOBAL ECONOMY: THE LONG WAIT

In the coming quarters, economic growth in the United States and the Eurozone should slow down and core inflation should move significantly lower. Monetary policy works with long and variable lags, so part of the impact of higher rates still needs to manifest itself. This is taking more time than expected. It has been a long wait thus far. In the US, the economy in general has been particularly resilient although some data have softened as of late. In the Eurozone, the labour market remains strong, yet, many data have weakened, including in services. A factor that will also play a role in coming months are the developments in China where activity indicators published during the summer confirmed the rapid slowdown in growth. Eurozone core inflation has hardly declined from an exceptionally high level and in the US it also remains sticky, albeit to a slightly lesser extent. Quoting Jerome Powell at Jackson Hole, central banks will have to “keep at it until the job is done.”

In the coming quarters, economic growth in the US and the Eurozone should slow down and core inflation should move significantly lower. Considering the cumulative monetary tightening seen thus far, it is hard to imagine otherwise. In addition, although we think that the terminal rate in both jurisdictions has been reached, they could move higher still, or the respective central banks might decide to keep rates high for longer.

This would imply a bigger headwind to growth. Monetary policy works with long and variable lags, so part of the impact of higher rates still needs to manifest itself. This is taking more time than expected. It has been a long wait. A key factor behind the resilience of the economy is the dynamism of the labour market and the very low rate of unemployment, which benefit from the elevated order book levels of companies. In addition, pent-up demand has boosted activity in the tourism and recreation sector and energy transition related investments are also supporting growth. The latter point was emphasized by ECB President Christine Lagarde in her Jackson Hole speech<sup>1</sup>.

In the US, the economy in general has been particularly resilient faced with the aggressive monetary tightening by the Fed. The positive surprise of second quarter GDP<sup>2</sup> and recent strong data have led the participants of the Philadelphia Fed’s quarterly survey of professional forecasters to revise upwards their forecasts for the next three quarters and downward their forecasts for the unemployment rate<sup>3</sup>. For the current quarter, the Atlanta Fed’s nowcast projects an impressive growth rate of 5.9% (seasonally adjusted annualized rate), underpinned by strong retail sales and housing starts data for the month of July. Although this number can fluctuate a lot depending on the data releases, it does seem to imply that the US is not about to enter a recession soon, at least according to the GDP metric.

<sup>1</sup> “In the euro area, for instance, investment rose in the first quarter of this year amid stagnant output, in part because of pre-planned investment spending under the Next Generation EU programme.” Source: Policymaking in an age of shifts and breaks, Speech by Christine Lagarde, President of the ECB, at the annual Economic Policy Symposium «Structural Shifts in the Global Economy» organised by Federal Reserve Bank of Kansas City in Jackson Hole, Jackson Hole, 25 August 2023.

<sup>2</sup> On a seasonally adjusted annual rate, real GDP grew 2.4% in the second quarter (+2.0% in the first quarter), against a Bloomberg consensus forecast of 1.8%. Source: Bloomberg.

<sup>3</sup> For quarterly real GDP growth (annualized rate), the forecasts are (previous survey data shown between brackets): 1.9% (0.6%) in the third quarter and 1.2% (0.0%) and 1.1% (1.0%) in the two following quarters. The unemployment rate forecasts are respectively 3.6% (3.8%), 3.7% (4.0%), 3.9% (4.2%). Source: Federal Reserve Bank of Philadelphia, Third Quarter 2023 Survey of Professional Forecasters, 11 August 2023.

### PMI : LEVEL AND MOMENTUM

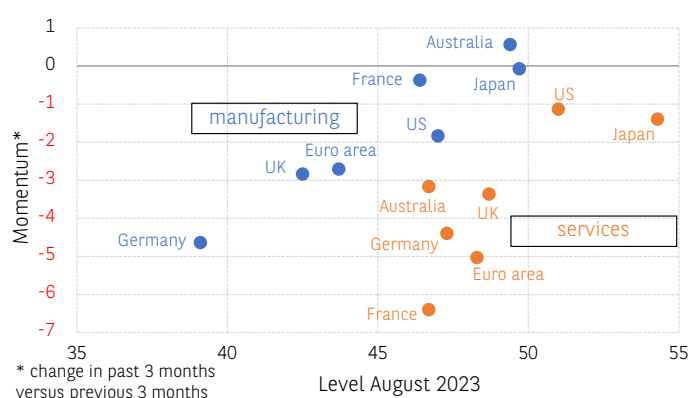


CHART 1

SOURCE: S&P GLOBAL, BNP PARIBAS

Nevertheless, some data have softened as of late. Job openings and the pace of hiring continue to trend down and the number of voluntary departures (quits rate) is also declining. Importantly, the manufacturing ISM, although edging higher in July (from 46.0 to 46.4), remains well in contraction territory. The situation is less bad in services where the ISM index was at 52.7 in July but that represents a decline from 53.9 the month before. The S&P Global flash composite PMI for August dropped to 50.4 (52.0 in July) on the back of weaker data in services and particularly manufacturing.

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In the Eurozone the labour market remains strong and core inflation has hardly declined from an exceptionally high level. Yet, many data have weakened. Admittedly, GDP growth in the second quarter of +0.3% (quarterly rate, non-annualized) was satisfactory but it is masking big differences at the country level. The sizeable gap between the manufacturing and the services PMI has narrowed following the significant decline of the latter and business surveys in Germany and France were weak in August. A factor that will also play a role in coming months and in Germany in particular, are the developments in China where activity indicators published during the summer confirmed the rapid slowdown in growth. Exports continue to decline as a result of slowing world demand and tensions with the United States, and domestic demand remains weak, partly dampened by falling consumer and investor confidence. The housing crisis is getting worse, with new developer payment defaults, and there are growing signs that some financial institutions are becoming more fragile.

As mentioned before, given the extent of monetary tightening, growth as well as core inflation are bound to slow down in the coming quarters. The real question is the timing and, above all, the speed. Thus far it has, on the whole, been a long wait, in particular in terms of core inflation, which remains very sticky in the Eurozone and, to a slightly lesser extent, in the US. It is likely that ongoing growth resilience would initially be greeted with relief by households, firms and financial market participants, fueling hopes of a soft landing and immaculate disinflation. Upon further reflection, it may very well become a source of concern, because of its implications for inflation -slower disinflation- and monetary policy, i.e. higher rates. Too slow a pace of disinflation could unnerve market participants and central banks alike considering that the latter will, to quote Jerome Powell at Jackson Hole, *"keep at it until the job is done."*<sup>4</sup>

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<sup>4</sup> Source: "Inflation: Progress and the Path Ahead", Remarks by Jerome H. Powell, Chair Board of Governors of the Federal Reserve System at "Structural Shifts in the Global Economy," an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, 25 August 2023.

