GLOBAL ECONOMY: GROWTH AT RISK

When growth is slowing, risks tend to be tilted to the downside because households and companies adopt a more cautious attitude in their spending and investment decisions. At the present juncture, it is also difficult to see what could create an upside surprise. To the contrary, according to the IMF, there are several downside risks: the cost of energy, the problems in Chinese real estate, persistent disruptions in the labour market. Financial conditions could deteriorate. Already today they create a discomforting environment, with the risk of a non-linear impact on growth. It illustrates the challenge of central banks with growth-at-risk being at the low end of historical ranges and inflation at the other extreme.

Global growth is slowing and risks are tilted to the downside. This asymmetry is a usual phenomenon during cyclical slowdowns. As households and companies become less confident about the outlook, they adopt a more cautious attitude in their spending and investment decisions, even though they are not financially constrained.[1]

This attitude may reinforce the negative dynamics of demand and activity and cause negative growth surprises whereby growth turns out to be lower than expected.

At the present juncture, it is also difficult to see what could create an upside surprise. One can consider that the current slowdown is, to a large degree, the consequence of high energy prices, elevated inflation and a tightening of financial conditions on the back of significant increases in official interest rates decided by a large number of central banks[2].

It doesn't seem like that energy prices would come down soon -the recent production cuts announced by Opec Plus point in the other direction- nor that inflation would decline faster than expected. The experience this year has been that the expected peak in inflation had to be pushed back, due to new supply shocks but also because inflation persistence had been underestimated (chart 1). Consequently, central banks will remain very cautious in signaling that no further tightening would be necessary.

On the other hand, there are several downside risks. The IMF's latest World Economic Outlook (WEO) considers four of them in its risk assessment to the growth outlook: higher oil prices, a further worsening of the crisis in the Chinese property sector leading to a decline in real estate investments, lower potential output from persistent disruptions in the labour market and a further tightening of financial conditions.[3] Taken together, these factors would cause higher inflation next year -triggering more rate hikes- and lower inflation thereafter.

In this downside scenario, global growth would slow from +2.7% in the base scenario to +1.1% in 2023, which is in the 15th percentile of the historical distribution. Chart 2 shows in this respect how the IMF's forecast compares to the annual growth observed since 1980. In the base case, 2023 is expected to see below-median growth, with an especially weak performance in the advanced economies.

Even in the absence of new shocks, current financial conditions already create a challenging growth environment, dominated by downside risks. The IMF points in this respect to elevated financial vulnerabilities in the sovereign and nonbank financial institution sectors as well as the deterioration of market liquidity in key asset classes.

EVOLUTION OF INFLATION FORECASTS IN 2022

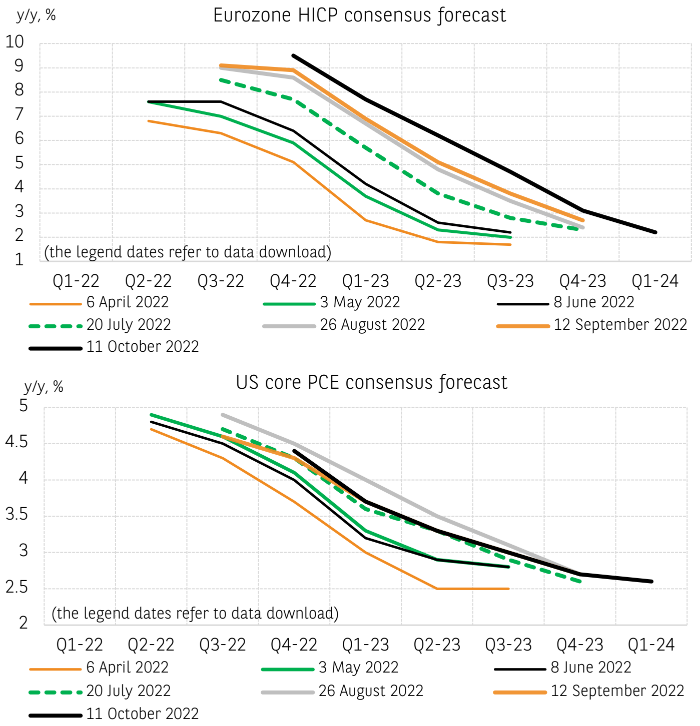

CHART 1 SOURCE: BLOOMBERG CONSENSUS, BNP PARIBAS

1. This is illustrated by a recent survey showing that close to 40% of CFOs of US companies cite the need to preserve cash as a reason for not planning to make equipment or structures expenditures over the next six months. This is the second most important factor, after the absence of need to expand capacity, which is mentioned by approximately 55% of survey respondents. Source: Duke University, Federal Reserve Bank of Richmond, Federal Reserve Bank of Atlanta.
2. Depending on the country or region, other factors also play a role such as food price inflation, the Chinese property crisis and the geopolitical uncertainty caused by the war in Ukraine.
3. In this adverse scenario, oil prices are pushed up 30 percent, on average, for 2023 relative to the baseline scenario- and start to decline thereafter. In the base case, the price of oil is assured to average USD 98.19 a barrel in 2022 and USD 85.52 a barrel in 2023. A tightening of financial conditions would manifest itself through a significant depreciation of emerging market currencies, higher sovereign and corporate risk premiums in emerging markets and wider corporate bond spreads in advanced economies.

These may end up having a non-linear impact on growth. *"The balance of risks is significantly skewed to the downside. The range of adverse GDP growth outcomes based on the probability distribution of future GDP growth is in the worst 20th percentile of the last four decades."*[4][5] It illustrates the challenge of central banks with growth-at-risk being at the low end of historical ranges and inflation at the other extreme.

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REAL GDP GROWTH SINCE 1980
(RANKED BY ASCENDING VALUE)

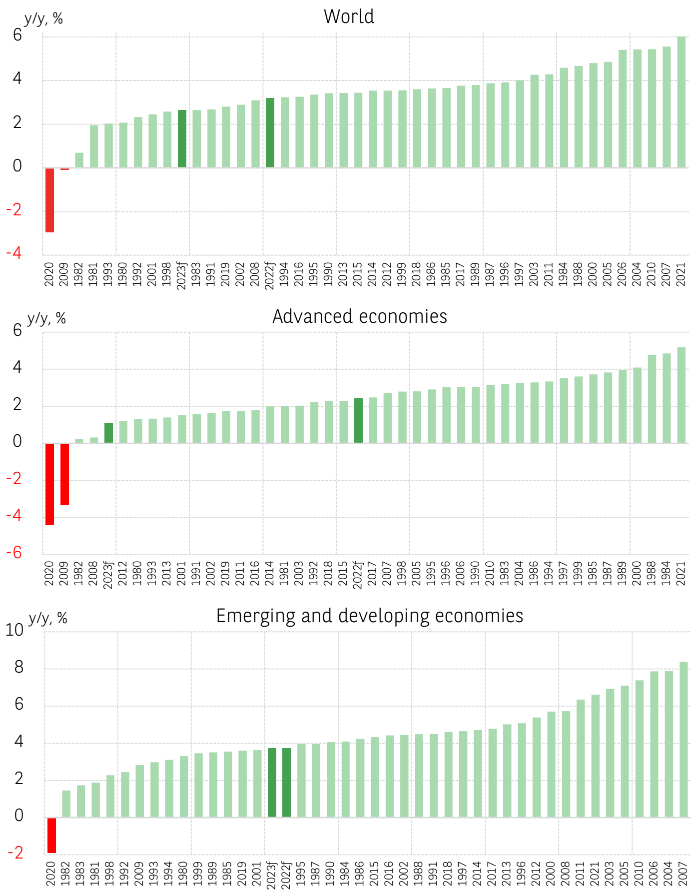

CHART 2

SOURCE: IMF (WORLD ECONOMIC OUTLOOK, OCTOBER 2022), BNP PARIBAS

4. This is based on the IMF's growth-at-risk approach, which uses financial indicators -asset prices, credit aggregates, etc.- to forecast the probability distribution of future GDP growth. 'Growth-at-risk' corresponds to the 5th percentile of this distribution. For a detailed explanation see: IMF, GFSR, Chapter 3, October 2017.
5. Since 2008, years in which growth-at-risk corresponded to a bottom quintile growth performance were 2008, 2009, 2010, 2011, 2020.

What better illustrates the challenge of central banks than the observation that growth-at-risk is at the low end of historical ranges and inflation at the other extreme?